

# A Focused Approach To Saving Money in the Federal Budget: Lessons from the DoD

By Kevin Green

The nation's looming financial crisis, fueled by trillion-dollar-plus annual federal budget deficits, has compelled all U.S. government departments and agencies to adopt cost-reduction campaigns and efficiency initiatives. Moreover, pressure to increase the savings targets is growing. The Department of Defense (DoD) provides an instructive example in this area.

U.S. Secretary of Defense Robert Gates announced in August 2010 that he would find \$101.9 billion dollars in defense budget efficiency savings, resulting in real growth of one percent annually from FY2012–2016. The military departments would retain these savings and reinvest them in modernization and force structure. On January 6, 2011, Gates announced that the Office of Management and Budget (OMB) had reduced DoD's FY2012–2016 budget by \$78 billion and claimed that DoD had found \$154 billion in savings over the Future Years Defense Program (FYDP). Of the \$100 billion in savings found by the department, Secretary Gates withheld \$28 billion to pay for "higher than expected operating costs" (health care, pay and housing allowances, and base support), which left the services only \$70 billion (not \$100 billion) to reinvest. DoD-wide efficiencies and freezes in civilian positions and salaries were supposed to generate another \$54 billion in savings, still short of the OMB cut of \$78 billion.

How did Secretary Gates square the circle? By cutting force structure (27,000 soldiers and 15,000-20,000 Marines), which had been off the table five months earlier. In the 2010 midterm elections, the GOP said they were going to cut \$100 billion from President Obama's FY2011 budget request. Because of the election, Congress didn't really try to pass a FY2012 budget by September 30, 2010 and has been funding the U.S. government at FY2010 levels by a series of continuing resolutions. By the first of April, with half of FY2011 past (and funded at last year's level), proposals for spending reductions (from the President's request) came to \$74 billion—\$58 billion from appropriations unrelated to national security and \$18 billion from DoD. Since the fiscal year was well underway, the Congressional Budget Office (CBO) said this would actually require "only" \$32 billion



in cuts in projected spending over the rest of the year. GOP leadership came up with another \$26 billion in actual cuts. And the story continues.

The *Washington Post* reported on February 11, 2011, that Rep. Jeff Flake (R-Ariz.) said the defense cuts weren't real because the leadership's \$16 billion reduction actually gave the Pentagon a two-percent increase over its current spending level (at FY2010 levels via the CR): "That's kind of bothersome to a lot of us." Gates has said several times that having to live with this two-percent increase would create a "crisis" for DoD, in part (according to the February 13, 2011, *Washington Post*) because the military services had been spending at close to the requested 2011 level. Apparently, efficiency initiatives or cost-reduction/cost-take-out campaigns with their savings targets are no longer enough. Congress wants to see reduced levels of spending. And since it controls the purse strings, the pressure to cut spending will only grow.

Government managers have spoken before of savings gained through greater efficiency—the "revolution in business affairs" and "defense business transformation"—now they



*Kevin Green is a vice president in IBM Federal, responsible for the Department of Defense and the Intelligence Community.*

must walk the walk and generate bankable savings that free up dollars to meet lower budget ceilings.

In the private sector, the market imposes discipline and accountability. Inefficient companies go out of business or are acquired and restructured. Commercial companies have developed many different approaches—business re-engineering, business process management, and organizational change management, to name a few—but the key mechanisms for putting teeth into cost-reduction campaigns remain the same—quantifiable performance measures and performance-based compensation. In the private sector, the market punishes those firms that don't execute or innovate: on any year's list of Fortune 500 companies, about one-third will be gone in seven years. How is this discipline and accountability imported into the public sector? Cabinet departments and government agencies are rarely disbanded; quantifying government outputs seems nigh impossible; and civil service regulations and Congressional statutes govern compensation.

A typical GAO report will tell the government that it needs to clearly and specifically define roles and responsibilities and formulate integrated strategic plans with specific goals, performance measures, and accountability mechanisms to monitor progress. Government entities are constantly tinkering with their wiring diagrams, re-defining responsibilities, and producing one plan after another, but without results. In 2008, Gates tried to achieve savings through "in-sourcing," but admitted in mid-2010 that the promised savings never materialized, observing that replacing contractors with DoD civilians did not significantly reduce costs because one DoD person did not do the work of two to three contractors. In August 2010, Gates froze civilian hiring for three years and mandated a 10-percent cut in contractors per year for three years in an effort to get bankable savings. On being told that adoption of an e-form solution would save X number of man-years per year, an astute and very experienced government manager responded: "Oh, I believe your efficiency gains, but all you are doing is freeing up time for the same number of

personnel to do additional work, since there's always more work to be done. You only get bankable savings when people are let go and we don't do much of that around here."

## Finding Real Savings

This is not a big-bang approach that reforms *Planning, Programming, Budgeting, and Execution System (PPBES)* or assumes that the federal government's underlying, dysfunctional incentive structure magically changed overnight. It's also not predicated on the false assumption that if everybody



Secretary of Defense Robert Gates speaks at a ceremony for the signing of the National Defense Authorization Act for Fiscal Year 2010 in the East Room as U.S. President Barack Obama looks on at the White House in Washington.



simply did their job better, the problem would be solved. It's a focused, leadership-driven campaign to wring real savings out of the budget. It consists of five steps:

- **Demonstrate leadership commitment to use commercial best-practices to save money.** Achieving real savings in government takes energy, discipline, and focus by the head of the department—see Bob Gates.
- **Appoint and empower a full-time cost-reduction leader with commercial business-management experience.** The department secretary has to recruit an experienced senior executive who actually knows how to cut costs and, reporting directly to the secretary (and deputy) has the necessary authority—and accountability—to make it happen.
- **Establish one financial management system for the organization and make everyone use it.** The department secretary (and her deputy) must make it clear that decisions are based *only* on information residing in the department's financial system.
- **Addressing one business area at a time, establish baseline levels of spending, set savings targets, and assign implementation responsibility.** Take savings at the beginning of the year and bank them.
- **Hold monthly leadership meetings to review cost-reduction programs.** As Enforcer-in-Chief, the secretary ensures accountability for execution and implementation.

Adopting this five-step campaign to achieve bankable savings will require, for example, the secretary of defense and his senior team to expend considerable political capital in establishing a separate process inside the Pentagon and getting decisions approved on the Hill. This is not a trivial matter. Ashton Carter, under secretary of defense for acquisition, technology, and logistics, noted in a February 2011 speech

(as reported by *Inside the Pentagon* on February 24, 2011) that everything he does to field equipment for the wars in Afghanistan and Iraq has to be done outside the Pentagon's "cumbersome," "inexcusably complicated and debilitating" acquisition system that "wastes money," "adds time" and "makes the process much harder than it should be." For every department, the political obstacles to achieving bankable savings are daunting, particularly when they are done through regular processes, and will be overcome only by a serious, determined effort by the department's senior leadership.

## Leadership Commitment

The head of any organization—the Chief Executive Officer (CEO) of a company, the secretary of a department, or the director of an agency—writes the script and sets the tone of an organization. She defines the vision of where the enterprise is going, sets the strategic direction, and establishes priorities. Her focus should be the organization's focus. An organization's leader, however, has to recognize that it is not just what she says. Visions, plans, and words are all statements of intent. It's the actions that are taken—or not taken—that really matter. If the CEO doesn't follow up and make sure that decisions are converted into actions by subordinates in the organization, plans and decisions can become empty words. This is particularly true in public-sector organizations, because they lack the key accountability mechanisms of the private sector—markets, quantifiable performance measures, and performance-based compensation. How the leader of an organization spends her time is often the most accurate measure of what is really important to her. Leaders have many ceremonial demands and give lip service to many objectives and programs. Their real focus and priorities are reflected in their schedules. DoD, for example, promised first a revolution in business affairs (under Secretary Cohen)



U.S. Navy



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Ashton Carter, Undersecretary of Defense for Acquisitions, speaks during a news conference at the Pentagon in Arlington, Virginia.

and then defense business transformation (under Secretary Rumsfeld). However, it wasn't until early 2009, when Secretary Gates became deeply involved in defense budget decision-making and started making tough decisions, that DoD started living within its means and got serious about becoming more efficient.

## Empowered Cost-Reduction Leader

The CEO/COO model that is prevalent in the private sector has rarely worked in the federal government. The secretary of any department has a huge job, if only because his board of trustees is the U.S. Congress, which also provides revenue for his department. The secretary of defense has at least 15 direct reports in just the Office of the Secretary of Defense (OSD). He needs his deputy to serve as his alter-ego in many capacities, not just as the chief operating officer. While some deputy defense secretaries have been very attentive to management (e.g., John Hamre and Gordon England), others have not. When Congress mandated that DoD establish a chief management officer (CMO) in OSD and the military departments, the Pentagon insisted that the CMO function be given to the deputy secretary and the departmental under secretaries.

Management of large, complex government organizations is too difficult, particularly when that organization is trying to cut costs, to be an additional duty for an already overstretched deputy, under or vice. DoD's own Defense Business

Board approved (on January 20, 2011) a task force report concluding that dual-hatting the deputy secretary as the CMO had not worked and that the secretary should "designate a comparable senior leader" to become the "lead cultural change agent" in creating the "culture of savings" that Secretary Gates had called for (Inside the Pentagon, January 27, 2011). In close cooperation with Congress (which must confirm these appointments and then collaborate with them), department secretaries (and agency directors) should recruit highly respected and experienced former COOs and CFOs from the private sector to serve as their departments' *uber managers* and empower them as the leaders of the cost-reduction campaign.

## One Financial System

Congress passed a law in 1990 that requires all federal agencies to pass independent audits. The DoD Comptroller told the Congress in 2006 that it might be able to do so by 2015. The U.S. Marine Corps, by far the smallest of the military services, made a "good try" effort in 2010, but it was cancelled and the Corps was told to try again next year. DoD, perhaps the most unmanageable of the federal departments, has over 4,000 accounting, financial, and inventory systems and spends nearly \$16 billion annually to maintain and modernize its business systems. During the Bush administration, DoD created (under pressure from Congress) a top-level oversight committee headed by the deputy secretary (the Defense Business Systems Management Committee or DBSMC) and a Defense Business Transformation Agency, which has eight directorates. As part of Gates' Efficiency Initiatives, this organization is being disbanded.

An organization can't save money unless it knows how it spends its money. The first task of a department secretary, his comptroller and his cost-reduction leader (or CMO if there is one) is to establish **one** financial system and firm financial controls throughout the department. Imposing a financial system on fragmented units is easy in concept, but requires political muscle, discipline, and constant follow-through. Once his team has set up the financial data center with open software, the secretary (and his deputy) must make clear that they will make decisions based **only** on information in the department's financial system.

## Baselines and Savings Targets

The cost-reduction leader, in collaboration with the comptroller (and her new financial system), the director of the analytic element (in DoD: Cost Assessment and Program Evaluation or CAPE), the secretary's top policy adviser, and the leaders of the principal operating elements (in DoD:





the service secretaries and chiefs), then establishes the baseline for each business area—essentially how much is being spent on what function or activity. Part of the empowerment of the cost-reduction leader is the authority to resolve disagreements over what the baseline really is. For each business area or central activity—supply chain management, financial management, IT rationalization and consolidation, human capital management, etc.—the cost-reduction leader sets cost-savings targets based upon best commercial practices.

From an IBM perspective, this means applying its own successful cost-reduction standards and practices to the government. The scale and complexity of IBM's global operations—33,000 suppliers, 45,000 business partners, and 78,000 productions with three million possible configurations—mirrors that of DoD. In about a decade, IBM collapsed 30 different supply chains into one, and in just three years (2003-2005) generated nearly \$25 billion in cost savings with a 21 percent cut in logistics costs. DoD uses 550,000 personnel and spends about \$90 billion annually on non-maintenance logistics activities. Using IBM practices, DoD could save \$19 billion annually. IBM went from 128 chief information officers (CIOs) down to one; reduced its

data centers from 155 to five, consolidated 80 web hosting centers to six; consolidated 31 networks into one; and went from 16,000 applications to fewer than 5,000. Over a four-year period, IBM reduced its total IT expenses by 54 percent. DoD's annual cost of IT applications development, operations, and maintenance is \$33 billion. Based upon IBM's experience, the cost reductions possible in IT rationalization and consolidation are \$7 billion to \$13 billion annually.

## Monthly Department Secretary Reviews

Establishing accountability in public sector organizations is tough. The military does it well, placing someone in charge (the joint force commander or JFC), giving him the authority needed to get the mission done (combat command authority of the JFC supersedes all other authorities in the area of operations) and holding him responsible for mission failures (e.g., captains of ships are removed even if they are not directly responsible for the error). Only the secretary of a department or a director of an agency can bring this kind of accountability to a cost-savings campaign. The cost-reduction leader can tell the secretary when somebody is not "making their numbers," but only the boss can impose discipline. This means the secretary must look her subordinate in the eye, ask how his actions are meeting her expectations, and if the answer is not satisfactory, impose discipline. A secretary who spends three hours each month personally reviewing three cost-saving plans in meetings staffed by the cost-reduction leader (in his role as informer) and attended by all the persons responsible for each business-area cost reduction plan would bring accountability to the effort and establish the culture of savings that every department secretary is seeking today.

## Final Thoughts

The time is now and the job can be done. A federal department's many and demanding missions do not recede in the face of financial challenge. Unsuccessful legacy management practices will not resolve expectations of improved efficiency. The choice before government leaders now is between reduction of operational capability and serious and effective change that improves financial performance and reduces outlays while providing functional capacity equal to the complex and growing challenges to the nation. ■