



**STRATEGY
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PRIVATIZATION: CURSE OR CURE

BY

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ABSTRACT

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Since the end of the Cold War in 1989, creation of a new world order has proven to be illusive, complex and frustrating. Expectations of a "peace dividend" failed to materialize and Americans, facing an uncertain future, seem determined to focus on internal issues - budget deficits, national debt, etc. - which imply a smaller and more efficient government structure. The current fad is to pursue privatization at any cost; it is fueling a revolution in the way government operates that will dramatically impact the nature of installation management. This paper will examine three areas where changes impacting installations are either imminent or in progress to achieve the desired outcome of smaller, more cost efficient government. To achieve such outcomes, a reinvented government must reach across the borders of bureaucracy into the uncharted territory of privatization as it impacts housing, human resource management and activity based accounting. It concludes that privatization is a business practice that is here to stay especially in the area of Army Family Housing. Most other efforts can be categorized as "marginal" reform, focusing on structural issues like reorganization and regionalization.

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PRIVATIZATION: CURSE OR CURE

INTRODUCTION

The cold war is over, but who's celebrating? Expectations of a "peace dividend" failed to materialize. Creating a new world order has proven to be illusive, complex and frustrating. Americans, facing a uncertain future, seem determined to focus on internal issues - budget deficits, national debt, etc., which imply a smaller and more efficient government structure. The report on the Roles and Missions of the Armed Forces states our national security strategy (NSS) is evolving to reflect world changes.¹ At home, changes for defense include: downsizing, the return of oversea's deployed forces to CONUS and increasing our capability to project forces abroad. As a result the responsibility for stewardship of defense installations is challenging in today's dynamic national security environment.

Installation management has become a complex business. Commanders are faced with a wide array of challenges - environmental compliance, quality of life, cost efficiencies, and divestiture to name a few. Unfortunately few commanders or their staffs have adequate training or experience to execute the business intricacies necessary to meet the challenges of installation readiness. The challenges facing installations staffs are diverse. Efforts to reduce infrastructure through base closures in 1988, 1991, and 1993 have met with marginal success. Costs/compliance for environmental clean-up and political considerations become obstacles to divestiture. Reducing the infrastructure is further complicated due to declining facility conditions and DoD's historic inability to program capitol improvements on facilities built during the 1940's to 1960's. Lower DoD budgets force commanders to make trade-offs between personnel, modernization and readiness priorities. Installation commanders and their

staff are left with difficult, often uneconomical, choices between fixing critical problems, sustaining quality of life (QOL), and initiating cost-reducing projects.

There is a revolution in progress in the way the government operates. The changes brought about by this revolution will dramatically impact installation management. This paper will examine three areas where change impacting installations are either imminent or in progress to achieve the desired outcome of smaller, more cost efficient government. To achieve such outcomes a reinvented government must reach across the borders of bureaucracy into the uncharted territory of privatization as it impacts housing, human resource management and activity based accounting.

PRIVATIZATION

Privatization, the transfer of government assets and/or operations to private business interests, is a recognition that government cannot be all things to all people. Unfortunately, our government has become entangled in its own power trying to solve today's social and fiscal problems with outmoded solutions. One effective alternative is privatization because government should not be, nor continue to get, in the business of business. Government's primary responsibility is making policy and monitoring standards for things that affect the public welfare, to include good and services provided by the private sector. Private enterprise, in a free market economy, produces goods and services in superior quality and quantity over that of a government agency for the following reasons.

1) Government ownership/control involves political influence on goods produced, investments in facilities, and personnel policies. Decisions based on political expediency rather than objective facts too often yield destructive results.

2) A government operation is normally protected by a partial monopoly, eliminating any market pressure to stimulate competition. The result is taxpayers have no choice but are captive/restricted to the government service.

3) In government operations consumers's interests - quality and price - are subordinated to the interests of the government agency.

4) A government agency does not keep abreast of the latest technology or cost saving developments or have little motivation to innovate.

The very nature of our democratic government with its checks, balances and procedures - the genius of our democracy - does not lend itself to managing a business function subject to a constantly changing marketplace. Such an operation is best served by an executive with full authority to act decisively.²

The Army's current interest in privatization began in the early 1980's. Declining defense budgets after Vietnam forced the services to consider various alternatives to achieve cost reductions. Privatization, along with its subset - outsourcing, emerged as promising alternatives. Privatization and outsourcing are two distinct, yet complimentary concepts, that are often mistakenly used interchangeably. Privatization involves turning over to the private sector an entire agency or function; while outsourcing is the contracting out of specific functions or services within an agency.

Initial attempts at privatization on installations involved the directorates of logistics (DOL) and public works (DPW). These directorates were studied in excruciating detail as

privatization candidates throughout CONUS. The studies were conducted under the auspices of OMB circular A-76 (Commercial Activities) published in 1983. Since FY 83, 331 A-76 cost competitions have been completed, with 154 in-house and 177 contract decisions respectively affecting over 20,000 positions.³ In addition to DOL and DPW, other functions studied included motor pools, visual information, custodial services, laundry, and food services. As functions were contracted, resistance mounted (aided by unions) and Congress passed the "Nichols Amendment" in 1987. This law gave the installation commander authority whether to conduct studies or not. Consequently, the number of studies initiated after 1987 declined dramatically.

OMB Circular A-76 stipulates how to conduct cost comparisons between government and commercial sources. The steps are as follows:

- 1) Identify a function or activity to study.
- 2) Solicit bid or proposals from private firms.
- 3) Streamline the in-house organization into a Most Efficient Organization (MEO).
- 4) Develop an "in-house bid" based on the MEO following detailed costing rules outlined in A-76.
- 5) Select the lowest bid or best value proposal from the solicitation, then add 10% of personnel-related in-house charges to accommodate intangible transition costs.
- 6) If the result is lower than the "in-house bid," privatize.
- 7) If the result is higher, reorganize into the MEO.⁴

Unfortunately the MEO's never existed, except on paper, making the validity of the A-76 comparison suspect at best. Step three appears somewhat contradictory, if a better organizational structure was possible, why wasn't it implemented or already in effect. Even in those cases where the in-house option was chosen, the MEO was often modified prior to implementation, making subsequent comparisons between projected and actual costs difficult.

Results that are available reveal mixed results. Dod, based on study results, claims a total savings of \$616M from 1661 studies conducted since 1979. However, a close look at specific cases where costs were monitored indicate DoD paid from 10%-30% more than the projected study savings.⁵ With the renewed emphasis on privatization, A-76's validity and relevance is being questioned.

Outsourcing, a subset of privatization, was first used by private industry in the 1960's. These efforts focused on blue collar jobs. Studies by the General Accounting Office identify blue collar workers as "... a recognized trade or craft, other skilled mechanical craft, manual labor occupations..." and their supervisors.⁶ Outsourcing by government agencies proved feasible because contractors provided similar service with fewer employees and by paying those employees less wages. The savings from outsourcing were quickly extinguished when Congress passed the Service Contract Act of 1965. This law requires contractor's employees to be paid the prevailing rates for similar employees in the locality.⁷

Private industry has used outsourcing as a management tool for redefining and reenergizing the corporation. It challenges executives to rethink the traditional vertically-integrated corporation in favor of a flatter, more flexible organization structured around core competencies. Non-core functions from fleet vehicle management to business support services to human resource staffing to information technology are prime candidates for outsourcing. U.S. companies out-source more than 100 billion a year with average cost savings of 10% to 15%; the federal government spent 114 billion on outsourcing in 1995, but

has no idea what savings, if any, were realized.⁸ Potholes that private industry has learned to avoid include: poorly negotiated contracts, excessive oversight, and accepting bids at face value. The goal of private industry is to out-source non-core functions thereby saving money and focusing energy on more strategic areas. The problem for government agencies is identifying non-core functions, and more importantly electing to privatize them before creating structure in personnel management systems to accommodate them. A recent opportunity lost was information management.

Investment banker William Mulrow likens the privatization of government assets and services to teen sex in the 1940's: "There's a lot of heat and discussion, but very little consummation." He also stated, "Money is the critical driving force behind privatization; if there's not a financial reason why privatization should occur, it won't happen and most of the time it doesn't." Additionally, the federal system has a set of personnel and procurement rules, regulations and laws that make privatization a monumental undertaking.

We are in a time when Congress is trying to cut the deficit, the Clinton administration is trying to reinvent the government, and the public is calling for less government. Privatization is seen as a magic bullet. The Clinton administration is in phase II of the National Performance Review which challenges federal agencies to "examine the basic missions of government, looking at every single program and agency to find and eliminate things that don't need to be done by the federal government."⁹ The Department of Defense began an initiative to identify activities that can better be undertaken by realignment within

DoD or by reallocation to...the private sector. As a result, there is renewed interest in privatization initiatives - especially at the installation level.

Congress has directed DoD to report on privatization opportunities and whether OMB Circular A-76 should be abolished. It further chose to allow the "Nichols Amendment" to lapse on its 30 September 1995 expiration date. The Commission on Roles & Missions (CORM) provided an aggressive, in-depth look at privatization. The CORM recommended that DoD outsource all non-core functions and that A-76 be withdrawn. OMB's response was to issue a revised, draft A-76 Supplement on 13 October 1995. Although the comment period ended on 15 December 1995, OMB has taken no further action on the revised A-76.¹⁰

The CORM identified the following non-core functions for immediate privatization review: depot maintenance, material management, finance & accounting, data processing, education & training, utilities, housing, and other base support services. A-76, as currently written, specifically precludes outsourcing of finance, accounting and data processing functions. OSD has established a Privatization Integrated Policy Team with a charter to implement the CORM recommendations either by enabling legislation or setting policy. The Army is aggressively pursuing several areas for privatization; one of which is Army Family Housing.

Family housing in DoD has never been a success story. This is reflected in the following statements:

- "...the best fed and worst-housed Army in the world." Surgeon General, 1887
- "Our Homeless Army" & "Army Housing: A National Disgrace"
Leading Magazines, 1924
- "... disgraceful living conditions ..." Secretary of Defense, 1950
- "There is only one aspect of the Department of Defense that is a disgrace - housing." Sen Coats, 1995

To address the problem the Army developed a vision for Army Family Housing (AFH) - to provide quality family housing by 2001. However AFH troubles are numerous. First, funding for AFH has decreased at a much faster rate than the inventory of housing units

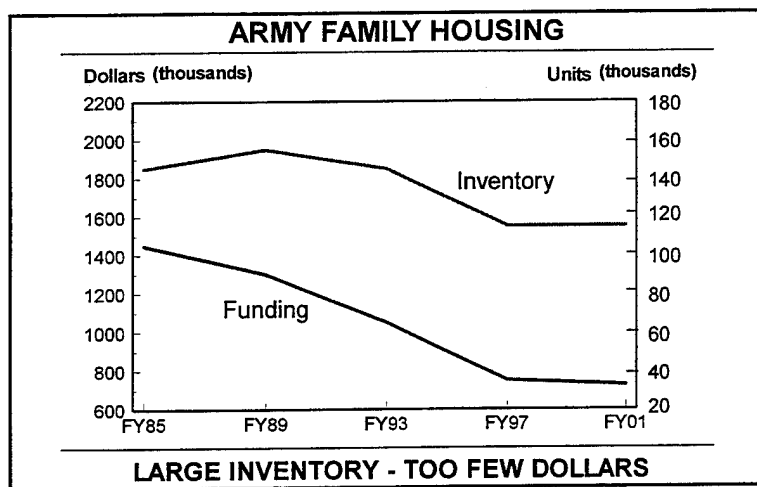


Figure 1

(Figure 1). Over the past decade discretionary, unpredictable, and generally insufficient funding has eroded the housing infrastructure. To fix the problem with dollars will require \$.4B per year for five years. Second, underfunding caused major maintenance to be

deferred creating a situation where renovation costs now equal one-half the replacement value of the inventory.¹¹ Third, existing laws preclude long term revitalization efforts because AFH is one-year money. Fourth, the downsizing of 250,000 service members has not reduced the demand for on-post housing, although not all installations have adequate demand solely from active duty service members to sustain maximum occupancy. In such circumstances it may be necessary to expand our paradigm on "Army" to include civilians, retiree's and in the case of government owned contractor operated facilities, contractor personnel.

Demand, at installations with large troop concentrations, remains strong as evidenced by long waiting lists. Families vacate economy quarters and move on post primarily for three reasons: first, security; second, environment; and third, cost. The small decline in housing units, reflected in Figure 1 is based on Base Reduction and Closing (BRAC) actions and scheduled demolition. To fix the problem of more assets than dollars through divestiture and demolition actions would require the elimination of 40,000 units.¹² This course of action is unacceptable for the following reasons: it requires significant up-front costs, it exacerbates the time soldiers wait for on-post housing, and it transfers the \$.4B deficit to the Military Personnel Account as families living off-post would now qualify for basic and variable housing allowances.

Three initiatives have been developed in an attempt to fix the AFH problem. They are: the Business Occupancy Program (BOP), Capitol Venture Initiatives (CVI), and privatization. BOP and CVI provide management tools to fix near term problems in support of the privatization initiative which will establish an external management structure for AFH.

The BOP was fully implemented on 1 October 1995, following a successful test at Forts Bragg, Sill, Detrick and

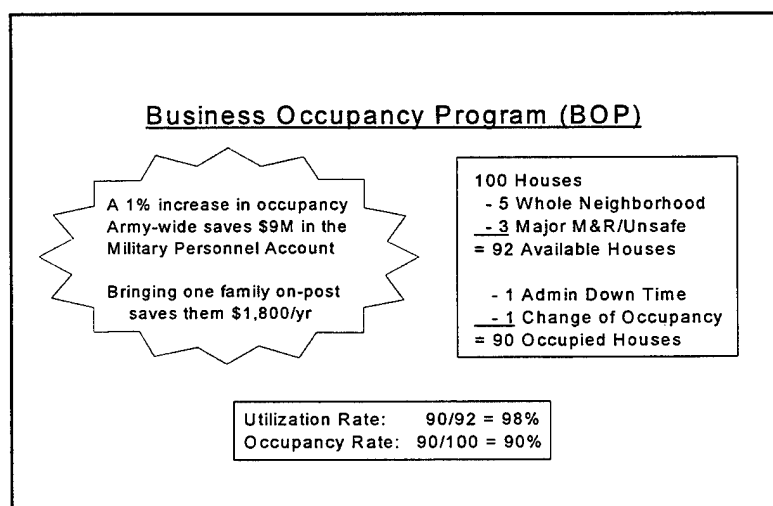


Figure 2

Aberdeen Proving Ground from February to September 1995. The BOP program (Figure 2) provides AFH funds to each MACOM based on an amount equal to housing allowances forfeited by occupants.¹³ The goal is to provide a predictable source of AFH funding for installations.

The utilization rate concept has been replaced with an occupancy rate as shown in Figure 2. With installation funding based on occupancy, commanders and housing managers can make decisions on scheduling repair and renovation to better maximize occupancy. Focusing on occupancy provides installations a means to control AFH income, reduce Military Personnel Account (MPA) requirements and potentially provide soldiers on-post housing quicker.

BOP is a new approach for the AFH business. Focusing on occupancy encourages housing managers to use good business practices. Occupancy is the key business factor whether housing is a government or private operation. Although the BOP stabilizes a portion of AFH funding, some funding remains uncertain due to fluctuations in annual appropriations. BOP is a step toward a sound business practice, but businesses do not operate on a one-year budget with no flexibility to roll-over dollars.

CVI was initiated by the Navy in 1995 with a focus on establishing limited partnerships for new housing. The CVI authority provided by Congress in the 1996 authorization bill expands the Navy program to include several business management tools for

requirements are extensive and in most cases installations are plowing new ground. Both the BOP and CVI are a collection of encumbered tools to attract private sector interest in on-post housing, yet neither erase the impediments to sound business practices.¹⁶

Privatization is an attempt to find an unencumbered, alternate management structure for AFH. A variety of options were considered with four alternatives emerging as possible solutions - 2 Army owned and 2 private ownerships - to meet privatization objectives. The two Army options are a Non-Appropriated Fund (NAF) instrumentality and a Not For Profit Entity (NFPE). The NAF option would operate with a central revolving fund with installation commanders controlling assets and operations. A NFPE would be similar to a NAF but have authority to buy, sell, trade, lease, etc., both housing inventory and land.¹⁷

Private alternatives are a Not-For-Profit Corporation (NFPC) or a For-Profit Corporations (FPC). Establishing a NFPC would require legislative action by Congress and include a Board of Directors appointed by the Secretary of the Army. A FPC would consist of one or more individual corporations (i.e., regional or at each installation) to assume function and ownership of housing assets. There are several pro's and con's to each alternative as highlighted in figure 4.

The comparison reveals that the best alternative is a NFPE, a government owned option. This option would establish an entity or organization that:

- is free from bureaucratic impediments to good business practices.
- owns the inventory, with land either out-leased or sold to the entity.

- works for the commander
- performs all housing functions on commercial basis
- collects rent from soldiers not to exceed housing allowances

Options Comparison				
Attributes	NAF	NFPE	NFPC	FPC
No-Year Money	X	X	X	X
Commercial Funding	X	X X	X X	X X
Contracting/Personnel Flexibility	X	X X	X X	X X
Freedom to Buy & Sell	X	X X	X X	X X
Speculation & Investments		X	X	X
Full Range of Tools		X	X	X
Removal of Profit Motive	X	X	X	
Army-Wide Coverage	X X	X X	X	
Transfer of Existing Obligations	X	X		
Army Keeps Asset/Fund Control	X X	X X	X	
Army Maintains Quality	X X	X X	X	

Figure 4

- would be able to commercially leverage Return On Investment (ROI)¹⁸

In addition AFH funds would be available to pay the projected increase to the MPA account. Setting up a government owned corporation appears to be a privatization-like approach; however delegating a government function to a government corporation is not pure privatization. The end result of privatization should enable the government or installation to more effectively focus on core functions - those things it should and can do; not add additional oversight burden which is what a government owned corporation will entail.

No matter which option is selected there exist some potential obstacles and pitfalls to successful implementation. The most obvious obstacle is the nature and culture of government bureaucracy itself. Traditionally, bureaucratic organizations define themselves by boundaries, both internal and external. Culture is how the relationships and core values

guide behavior in the organization. Today most of those relationships - with employees, the public, other offices/agencies and even other levels of government - are defined by rules, and the bureaucracy values strict compliance with those rules. So while congress, DoD, and the Army are quick to support new initiatives, such as privatization, they soon thwart their effectiveness by bureaucratizing or creating rules to control them. What a contradiction - I want change, but only if I can control it. Colleen Preston, deputy undersecretary for acquisition reform, summarized it perfectly - "We've got to stress insight instead of oversight. We've got to have minimum rules and regulations and empower people to use more discretion."¹⁹

Another pitfall is the freedom and capability of the installation commander and his staff to execute privatization of post housing. Greater empowerment of installation commanders to implement and manage a privatized housing initiative is a recommendation that on the surface appears to have much merit. Yet there is no evidence that housing privatization studies even address whether the installation staff possesses the business acumen to implement the new authorities envisioned under privatization. Further, there is continuing evidence that DoD supports greater centralization, not decentralization, of management functions through Defense Management Review initiatives in the areas of finance/accounting and civilian personnel management.

HUMAN RESOURCE MANAGEMENT

Installation commanders play an important role in human resource (HR) management. They must be able to envision the future. The current information technology revolution will, by some projections, de-skill 75% of the population. The half-life of many skills will average 3-5 years.²⁰ How does an installation commander or employee cope - continuous training. Although jobs and skills may become obsolete, it is not a good strategy to let your peoples skills lapse. HR must change from a rules-driven, compliance organization to a consulting role for all personnel functions to include teamwork and training. Training has historically not been a high priority and the first item sacrificed during times of tight resources and downsizing. To maximize their training capability, installations must marshal and integrate all internal HR resources.

DFCA COMPARISON - TRADOC							
INSTALLATION	ED CTR	ACAP	LIB	EO	CPO	AG	OTHER
Ft Rucker HRD DCFA		X	X		X	X	
Ft Huachua HRD DCFA	X	X	X	X	X	X	
Ft Gordon HRD DCFA	X	X	X		X	X	
Ft Benning DCFA			X		CPOC		PXLNO
Ft Bliss DCFA			X	X			
Ft Eustis DCFA			X	X	CPOC	X	PXLNO
Ft Jackson DCFA		X	X				
Ft Knox DCFA		X	X				
Ft Lee DCFA			X				
Ft Leavenworth DCFA			X				
Ft Sill DCFA		X	X	X			PXLNO

Figure 5

Consequently it is imperative to relook HR management both from an organizational and mission viewpoint. A survey of TRADOC installations indicates some are moving away from the traditional Deputy for Community and

Family Affairs (DCFA) to a HR organization.²¹ The mission of the HRD's shown are to oversee all personnel related activities, to include CPO, AG and training functions. Creation of an HRD will facilitate work-force planning or directing the work-force toward the skills and competencies that will be needed to accomplish the business strategies established by the agency.

Work-force planning involves forecasting attrition, recruitment and internal change or reprogramming. Accomplishing work-force planning in light of the economic, demographic and technological changes that are reshaping the working environment is difficult. These changes include: (1) significant downsizing; (2) reinvention of public service with a greater focus on responsiveness and customer service; (3) trend toward cultural diversity; (4) flattening of organizational structures; (5) reemphasis on ethics and integrity; and (6) renewed interest in outsourcing and privatization.²²

According to the Human Resource Institute that surveyed 200 Fortune 500 firms on their top 10 HR concerns for 1995 and their projections for 2005 (Figure 5), managing change and work force skill level remain the top two concerns for the next decade.²³ The same issues will apply to public/government employees. Managing change can be difficult especially if you're always picking up the pieces after the change occurs. The challenge is to be innovative and look for ways not only to manage change but also to influence it to create an organization that embraces change - as described by Peter Senge in "The Fifth Discipline: The Art & Practice of the Learning Organization."

Managing

change will not be an easy task for several reasons. First the current civil service system is a classic example of the obsolete "one size fits all" model. Further it is so heavily regulated,

despite laudable attempts to "sunset" the old regulations, that there is little room for real innovation in human resource management. For example the performance management systems are the same for all federal agencies even though their missions and organizational characteristics differ widely. The lack of flexibility to customize approaches to recruiting, hiring, training, and performance management impedes progress to improve employee performance.

Second commanders must deal with bureaucratic directed changes. A current example is OSD's initiative to regionalize civilian personnel offices (CPO). This concept will reduce the number of CPO's world-wide from 140 to 10 (Figure 6). Driven primarily by the need to gain efficiencies and economies through structural redesign and automation technology, the plan establishes 10 regional Civilian Personnel Operation Center's (CPOC) with Civilian

TOP 10 HR CONCERNS	
1995	2005
Managing Change	Work Force Skill Level
Work Force Skill Level	Managing Change
Health Care Costs	Information Technology
Management Issues	Aging Work Force
Work Ethics, Values, Attitudes	Management Issues
Improving Productivity	Quality of Education
Focus on Customer	Work Ethics, Values, Attitudes
Employee Communications	Managing Diversity
Information Technology	Improving Productivity
Reengineering	Employee Communications

Figure 5

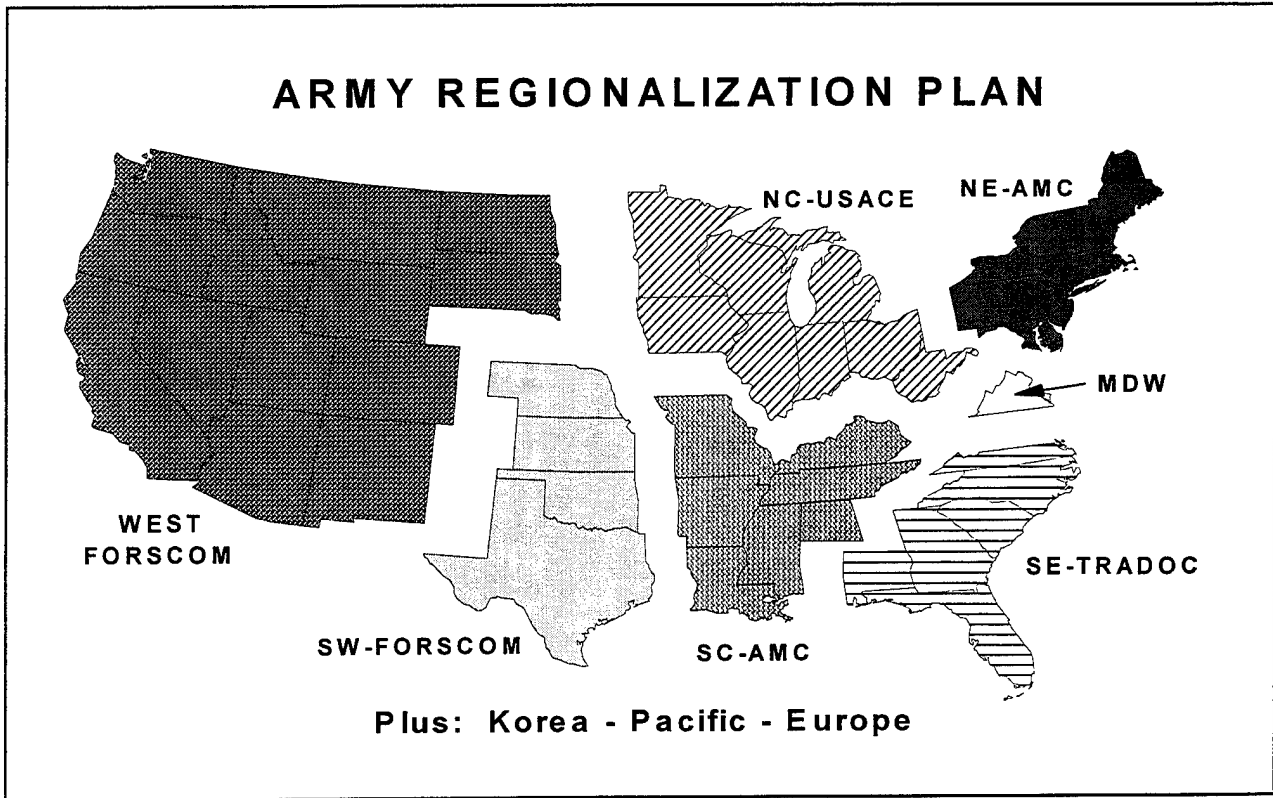


Figure 6

Personnel Activity Center's (CPAC) at remote installations.²⁴ The long term impact on customer support, the well-being of the work-force and effectiveness is unknown.

Automation underpins the entire concept and could develop into a show-stopper as the procurement of the necessary hardware and software to support regional operations is behind schedule.

Another top-driven change is classification reform. A carry-over problem from the obsolete "one size fits all" model of civilian personnel management which created a classification system that: (1) is too complex, (2) is inflexible to support rapidly changing missions, (3) does not support flatter organizational structures, and (4) fragments

responsibility. The current classification system consists of 22 families and 442 series. Reform efforts would consolidate families to 20 and reduce the number of series to 74.²⁵ The concept of broad banding employees into less series will make it easier for organizations to rapidly adjust their work-force to meet new or changing missions. Broad banding will redesign work away from discrete piecemeal tasks toward more integrated holistic processes. Classification reform will also have trickle down affects on performance management, recruitment, retention, and pay.

The restructuring revolution demands that employers and employees think longer and harder about their job skills. As the labor market becomes more unstable, employability, not life-time job security, will become the critical issue. As installation commanders implement privatization and regionalization initiatives, they have a responsibility to prepare employees for either new jobs or the possibility their jobs may disappear. Responsibility will shift to ensure employees are provided the training to acquire new skills or experience to progress either inside or outside the government bureaucracy. Taking care of people is taking on a whole new dimension that goes far beyond providing health care, pensions, and other expected benefits.

ACTIVITY BASED ACCOUNTING

Cost effectiveness or efficiency is the watchword of the hour. To accomplish that organizations must concentrate on core competencies (profitable products/services) and either

phase out, privatize or out-source non-core functions. According to Bala Balachandran, director of Accounting Research Center, Northwestern University, "Only 40% or so of cost information is reliable, the rest is stupid allocation." Activity based costing (ABC) is the only relief in sight for those hoping to make sense of costs.

For the past 50 years cost of a particular product or function has been determined by adding the cost of raw materials, the direct labor cost, and the overhead. The first two are relatively straight forward, the latter extremely complex as it includes everything from the bosses salary to janitorial services. To simplify the allocation of overhead - most companies use the "peanut butter approach". Spread it evenly over all products produced just like peanut butter is spread on bread. This system was acceptable in prior decades because overhead constituted 25% of costs and change occurred at a glacial pace. Today automation has reduced labor costs, yet environmental studies, occupational safety, and pensions, have increased overhead to where it often represents 60% of total cost. Allocation using the peanut butter principle is no longer unacceptable.²⁶

Traditional cost accounting assumes that a certain operation has to be done and that it has to be done where it is done now. ABC asks, Does it have to be done? If so, where is it best done. Installing an ABC system forces a organization to scrutinize what it actually does. Consequently, ABC fits nicely with the concept of defining core and non-core competencies. ABC permits organizations to define "centers" in which activities are grouped. A center can be a department or process. Cost information from the general ledger is then categorized and

linked to activities, or important functions, the organization performs. Costs identified with activities can then be tied to established centers. The result is an accounting system that facilitates the evaluation of departments, products and customers.²⁷

ABC can be an especially important tool for decision makers as it provides management information not previously available from traditional accounting systems. Yet use of ABC systems at the installation level is still being tested. These tests reveal that actual costs of providing services to customers was not known and in many cases the organization was losing reimbursable income by charging rates which were less than actual costs.²⁸ Unfortunately, because of the hierarchal nature and reporting requirements of our bureaucracy, implementation of ABC at installations cannot be undertaken as an independent action.

For installations there is no stable, definitive guidance on methodology to accurately determine costs. DODI 4000.19, which is DoD's guidance for reimbursable costing, is revised annually and each year becomes more ambiguous. The latest guidance is to reimburse incremental, identifiable and directly attributable costs. It eliminated the requirement that tenants pay their fair share of police, fire protection, and other overhead costs. Yet the installation is expected to provide these services even with declining base operations funding. Without an accurate costing system, the installation is unable to show proof of costing when negotiating Interservice Service Support Agreements or intercommand transactions, nor can it segregate mission and General & Administrative (G&A) funds. Implementing a ABC system is an effective and simple way to identify the costs of services to customers, activity costs and overhead.

Over the past year, the Armament and Research Development Engineering Center (ARDEC) has undergone a financial overhaul. A February 1995 General Accounting Office report cited the misuse of overhead accounts within Army Materiel Command to charge unfunded management and base support costs to mission accounts and reimbursable customers.²⁹ ARDEC formed a financial process action team to review cost allocation between G&A and mission organizations. The team recommended elimination of the mission support account, definition of core activities, and implementation of ABC to ensure the comptroller could provide the visibility and status of resources enabling prudent management decisions to be made. By implementing the principles of ABC the team was able to align the G&A budgetary data to the appropriate activities and corresponding business centers.³⁰

The result of ARDEC's review revealed that the organization needed to reduce spending to match funding. Specifically, reductions were needed in the Army Management Headquarters Activity and Base Operations. The PAT recommended, and had approved, a series of business rules and procedures to improve the management of resources. The Picatinny Resource Rules (PR²) for mission and G&A activities are shown in Figure 7.³¹ Mission activities are charged with paying all bills incurred by their operations, aggressively marketing their services, and divesting of unprofitable areas. G&A operations are limited to satisfying internal mission requirements, operate within institutional funding, and now include resource and information management activities. As a result of the above actions, business centers are held responsible and accountable for obtaining funding, justifying and defending personnel requirements, and financing all costs incurred by their activity.

PR² FINANCIAL RULES

Mission Activities

- Bill All Customers
- Use Central G&A Services - No duplication
- Pay All Cost By Business Unit

G & A Activities

- Do Not Bill Customers for G&A
- Provide Central Admin Services
- Do Not Pay Costs For Customer Operations
- Bill For Mission Costs

Figure 7

ABC is useful in identifying potential business process improvements and will raise the cost consciousness of managers as installations cope with reduced resources. The erosion of base operations

funding will continue over the foreseeable future and the historical trend to pull more funding than is replenished will continue as categories of services transfer from reimbursable to direct or vice versa. Installations continue to receive less funding yet are expected to provide more services. Without innovative approaches to pay for base support operations, the temptation to use/misuse mission funds will continue. ABC will provide installation's with the financial data necessary to pursue privatization and other initiatives prudently.

CONCLUSIONS/RECOMMENDATIONS

Privatization and outsourcing are business practices that are here to stay. Outside providers by the very nature of their specialization bring state-of-the-art business and technology solutions to the governments challenges in obtaining cost efficiencies. The key

for installation to know what to outsource is defining core and non-core competencies. Core competencies will be different for every organization as they form the organizations personality. But every organization - not just business - needs one core competence: innovation. The AFH initiative to explore privatization alternatives is an example of such innovation.

OSD and DoD are pursuing innovative alternatives to improve AFH. Regardless of whether a public or private solution is ultimately selected, the key is occupancy. In remote areas the definition of housing occupants may have to be expanded beyond active duty to civilian, retiree, and contractor to sustain high occupancy. A variety of private sector approaches to build and renovate housing faster are being investigated to lessen the cost to taxpayers. The new approach to involve the private sector to raise capital for development is an attempt to leverage scarce government dollars. In exchange for up-front renovation or construction, DoD is seeking legislative authority to guarantee rentals, make fixed payment commitments, and enter limited partnerships.

We are in an era when the government is determined to become leaner and more efficient. Rapid advances in technology are fueling reengineering initiatives changing the notion that government employee's can expect life-time job security. Employee job skills are likely to have short shelf lives. The result is a huge need for continual retraining. Managers must work with employees to ensure they acquire the new skills necessary to accomplish organizational missions. Given the inflexibility of the civilian personnel management

system and ongoing regionalization/reform initiatives, installation commanders must marshal their personnel activities into a cohesive HR organization responsible for preparing the existing work force for future challenges.

ABC was developed 5-7 years ago to meet industries requirement to determine the impact of changes in the cost and yields of every activity on the results of the whole organization. It has become a key instrument in assisting organizations determine the profitability of current operations and reengineering initiatives. It is an excellent tool for decision makers as it provides management information not previously available from traditional accounting systems. ARDEC, an engineering and research lab, where productivity was extremely difficult to measure under traditional accounting systems, has successfully demonstrated that ABC makes it possible to relate costs to individual business centers. Using ABC will enable installations to track costs by activity, identify areas where cost saving improvements are needed and allow activity heads to be responsible and accountable for funding.

Although rhetoric expounding major restructuring and downsizing is prevalent at all levels of government, true reform - cutting back or eliminating government programs - is still resisted. Most efforts can be categorized as "marginal" reform, focusing on structural issues like reorganization, regionalization, etc. Privatization, when purely implemented, transfers government assets, operations and services to the private sector enabling the government organizations to concentrate energy on core competencies.

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