

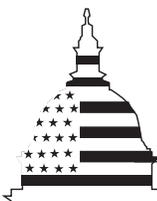
GAO

Report to the Chairman and Ranking
Minority Member, Subcommittee on
Readiness and Management Support,
Committee on Armed Services, U.S.
Senate

January 2002

BEST PRACTICES

Taking a Strategic Approach Could Improve DOD's Acquisition of Services



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Accountability * Integrity * Reliability

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United States General Accounting Office
Washington, DC 20548

January 18, 2002

The Honorable Daniel K. Akaka
Chairman
The Honorable James M. Inhofe
Ranking Minority Member
Subcommittee on Readiness
and Management Support
Committee on Armed Services
United States Senate

Federal agencies spend billions of tax dollars each year to buy services ranging from clerical support and consulting services, to information technology services such as network support, to the management and operation of government facilities, such as national laboratories. The amount spent on services is growing substantially. In fiscal year 2000, the federal government acquired more than \$87 billion in services—a 24-percent growth in real terms from fiscal year 1990. The Department of Defense (DOD) is, by far, the government's largest purchaser of services, acquiring more than \$53 billion in services in fiscal year 2000. However, our work, and the work of DOD's Inspector General, has found that this spending is not being managed efficiently.

The private sector is also increasingly reliant on services. The majority of purchasing dollars for some companies now goes to acquiring a range of services, including complex services such as advertising, information management, and professional consulting services to relatively simple services such as lawn mowing, waste removal, and temporary clerical services. In 2000, about \$2.1 trillion in services, including transportation, communications, health, legal, and other business services, was sold in the U.S. market place.

In recent years, leading companies have been examining alternative ways to manage their service spending to stay competitive, respond to market and stockholder pressures, and deal with economic downturns in key overseas markets. In looking at their service acquisitions, these companies discovered that they did not have a good grasp of how much was actually being spent and where these dollars were going. They found that responsibility for acquiring services resided largely with individual business units or functions—such as finance, human resources, manufacturing, engineering, or maintenance—which hindered efforts to coordinate purchases across the company. They also came to realize that

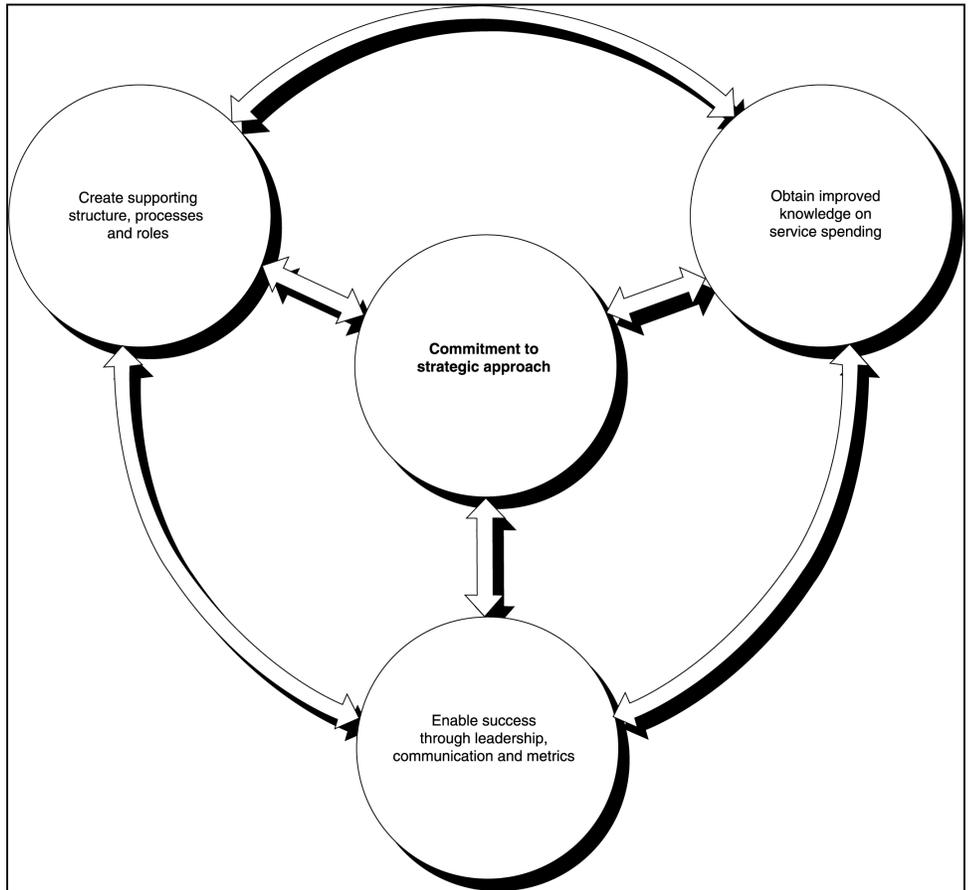
they lacked the tools needed to make sure that the services they purchased met their business needs at the best overall value. To turn this situation around, leading companies reengineered their approach to buying services.

You requested that we examine how leading companies reengineered their approach to purchasing services and the extent to which DOD is pursuing a similar approach. This report describes a strategic framework that leading companies have adopted that could help guide DOD's efforts. We plan to evaluate how specific best practices could be adopted or adapted for use by DOD on future assignments.

Results in Brief

The leading companies we studied made a number of dramatic changes to the way they bought services and found that these changes, in turn, resulted in significant cost savings and service improvements. These changes generally began with a corporate decision to pursue a more strategic approach to acquiring services. Taking a strategic approach involves a range of activities—from developing a better picture of what the company is spending on services, to taking an enterprisewide approach to procuring services, to developing new ways of doing business (see fig. 1).

Figure 1: Key Elements of Strategic Approach Taken by Leading Companies



Source: GAO analysis.

Once top leaders were committed to taking a strategic approach, the companies took a hard look at how much they were spending on services and from whom. By arming themselves with this knowledge, the companies could identify opportunities to leverage their buying power, reduce costs, and better manage their suppliers. The companies also instituted a series of structural, process, and role changes aimed at moving away from a fragmented acquisition process to a more efficient and effective enterprisewide process. For example, the companies we studied often established or expanded the role of corporate procurement organizations to help business managers acquire key services and made extensive use of cross-functional teams to help the companies better

identify service needs, select providers, and manage contractor performance.

Bringing about such changes was not easy. For example, some companies spent months piecing together data from various financial and management information systems and examining individual purchase orders just to get a rough idea of what they were spending on services. Other companies found that in establishing new procurement processes, they needed to overcome resistance from individual business units reluctant to share decision-making responsibility and to involve staff that traditionally did not communicate with each other. To do so, the companies found they needed to have sustained commitment from their senior leadership; to clearly communicate the rationale, goals, and expected results from the reengineering efforts; and to measure whether the changes were having their intended effects.

Taking a strategic approach clearly paid off, as companies found that they could save millions of dollars and improve the quality of services received by instituting these changes. In some cases, thousands of suppliers were reduced to a few, enabling the companies to negotiate lower rates. In other cases, new information systems enabled companies to better match their business managers' needs with potential providers. Company officials provided various estimates as to how much their companies saved by taking a strategic approach, with one official estimating his company had saved more than \$210 million over the past 5 years from pursuing more strategic approaches to purchasing information technology services, while another estimated his company typically achieved savings of 15 percent or more on efforts that were undertaken using the new processes.

The strategic approach taken by the leading firms we visited could serve as a general framework to guide DOD's service contracting initiatives. DOD has certain elements critical to taking a strategic approach already in place, such as the commitment by senior DOD leadership to improve its practices for acquiring services and to adopting best commercial practices. However, DOD has not conducted a comprehensive analysis of its spending on services or thoroughly assessed its current structure, processes and roles, two elements that companies found to be crucial to reengineering their approaches to purchasing services. DOD's size, the range and complexity of the services it acquires, the capacity of its information and financial systems, and the unique requirements of the federal environment are among the factors that DOD will need to consider in tailoring a strategic approach that meets its diverse needs.

This report includes a recommendation intended to help DOD assess whether a strategic reengineering approach, such as that employed by the leading companies we visited, could be used as a framework to guide DOD's reengineering efforts.

DOD commented on a draft of this report and concurred with the views expressed in the draft report. The DOD comments can be found in appendix I.

Leading Companies Applied a Strategic Approach to Acquiring Services

Over the past decade, federal agencies substantially increased their purchases of services, particular for information technology and professional, administrative, and management support services. But this money may not always be well-spent. Our work, as well as the work of other oversight agencies, continues to find that millions of service contracting dollars are at risk at DOD and other federal agencies because acquisitions are poorly planned, not adequately competed, or poorly managed.¹

To help improve how services are managed at DOD, we studied the practices for purchasing services at six leading private sector companies. We selected these companies, shown in table 1, based on literature searches and discussions with universities, industry associations, research organizations, and experts in purchasing practices.² The six companies have been recognized by their peers for reengineering their approach to purchasing services.

¹ *Contract Management: Trends and Challenges in Acquiring Services* (GAO-01-753T, May 22, 2001).

² More detailed information about our scope and methodology can be found on pp. 23 through 25.

Table 1: Leading Companies We Studied

Company	Function
Brunswick Corporation	A leader in the boating, marine engine, fitness equipment, bowling, and billiards industries.
The Dun & Bradstreet Corporation	A leading provider of business credit, marketing and purchasing information, and receivables management services.
Electronic Data Systems (EDS) Corporation	A leader in the information technology services industry, providing business and government clients high-value consulting, electronic business solutions, business process management and systems, and technology expertise.
Exxon Mobil Corporation	The world's largest integrated oil company, ranking first in profits, proven reserves, liquids production, natural gas production, oil production, and refining capacity.
Hasbro, Inc.	A leader in the design, manufacture, and marketing of toys and games, ranging from traditional to high-tech.
Merrill Lynch & Co., Inc.	A leading provider of investment, financing, advisory, insurance, and related products and services, ranking first in U.S. and global debt and equity underwriting.

Each of these companies is a leader in its respective market, but is not immune to market or stockholder pressures to improve performance. To respond to these pressures, senior corporate leadership challenged their companies to improve their performance, including the manner in which they acquired services. In turn, these companies reengineered their approach to acquiring services to leverage their buying power, reduce costs, better manage their service providers, and improve the quality of services acquired. As shown in figure 2, we identified four broad principles that were critical to successfully carrying out the companies' strategic approach. The companies we studied did not follow the exact same approach as they differed in the manner and degree to which they employed specific practices. However, the bottom line results were the same—substantial savings and service improvements.

Figure 2: Principles and Practices of Leading Companies**Commitment...***Secure up front commitment from top leaders*

- Recognize and communicate the urgency to change service spending practices
- Provide clear and strong executive leadership, including goals and targets

Knowledge...*Obtain improved knowledge on service spending*

- Develop information system to identify how much is being spent with which service provider for what services
- Analyze the data to identify opportunities to reduce costs, improve service levels, and provide better management of service providers

Change...*Create supporting structure, processes, and roles*

- Create or identify organizations responsible for coordinating or managing service purchases
- Establish proactive business relationships between end users, purchasing units, and other stakeholders
- Implement more integrated team-based sourcing processes
- Create commodity/service experts

Support...*Enable success through sustained leadership, communication, and metrics*

- Obtain sustaining support from senior leadership to facilitate change
- Establish clear lines of communication between all affected parties
- Demonstrate value and credibility of new processes through use of metrics

Source: GAO analysis.

The principles and practices largely reflect a common sense approach toward almost any business venture, that is, providing good leadership, developing and harnessing knowledge, making sure business processes maximize return, and measuring results. Yet the practices represented significant changes to the way services were traditionally acquired. Company officials generally described their previous approach to acquiring services as being fragmented, with only limited corporate visibility and control over the amount spent on services by their business units. Existing information systems provided only scant information on services. For the most part, service acquisitions were viewed as a mission support activity and peripheral to the bottom line, rarely capturing the attention of top management. As one company official described it, the traditional approach taken by his company, and most companies, resulted in spending for services “just happening.”

Securing Up-front Commitment from Top Leaders

In each of the companies we visited, the support and commitment of senior management was viewed as essential to facilitating the company's efforts to reengineer its approach to acquiring services. Company officials indicated senior management provided the direction and vision; facilitated the development of common processes and approaches; and, when necessary, provided the clout necessary to obtain initial buy-in and acceptance of reengineering efforts. Senior managers expressed commitment in various ways, ranging from restructuring the corporate procurement function, to providing greater visibility and authority over the company's service spending to issuing a memorandum signaling their support for a new way of doing business. Table 2 highlights changes that were common in the companies we studied.

Table 2: Changes in Senior Management's Involvement in Their Company's Purchase of Services

Traditional	Strategic
Services viewed as ancillary to core business.	Services viewed as central to core business.
Senior managers not actively involved in pursuing changes to how the company acquires services.	Senior management provides direction and vision for change, establishes goals and targets, and devotes increased attention to services.

Source: GAO analysis.

In general, successful reengineering efforts are spearheaded by a company's senior management since they have the authority to require employees to accept reengineered roles, the responsibility to set the corporate agenda and to define the organization's culture, and the ability to remove barriers that block changes to the organization's corporate mindset. Prior research has found that the lack of top management commitment is the cause of most reengineering failures.³

Obtaining Better Knowledge on Service Spending

The companies we visited analyzed their spending on services to answer the basic questions of how much was being spent and where the dollars were going. After conducting the analyses, the companies realized that they were buying similar services from numerous providers, often at greatly varying prices. Such knowledge brought home the need for

³ *Reengineering Organizations: Results of a GAO Symposium* (GAO/NSIAD-95-34, Dec. 13, 1994).

companies to become more strategic in planning and managing their service acquisitions to maintain a competitive edge. Table 3 highlights the differences in the availability and use of spending data between the practices traditionally used by companies and those pursuing a more strategic approach.

Table 3: Comparison of Traditional and Strategic Approaches to Spending Data

Traditional	Strategic
Financial and information management systems focus on components and materials used to make products, but do not provide data needed to effectively manage the company's service spending.	Systems are developed to provide credible, reliable, and timely data on acquired services.
Data is used principally for "after-the-fact" reporting purposes.	Data is used to identify opportunities to rationalize supplier base and reduce costs.

Source: GAO analysis.

The benefits of having credible and reliable data on service spending were substantial. Companies used this data to "rationalize" their supplier base, or in other words, to determine the right number of suppliers that met their needs. Once the companies determined how many suppliers they needed to meet their needs, they could then use this data to help them better leverage their buying power. Table 4 illustrates how companies used spend analyses to identify opportunities to rationalize their supplier base and reduce costs.

Table 4: Examples of How Service Spend Analyses Benefited the Companies We Studied

Company	What the spend analysis revealed	What the company did with this knowledge
Hasbro	Hasbro’s spend analysis revealed that it had 17 providers of temporary administrative, clerical, and light industrial personnel for 7 locations. The company also found that it had inconsistent policies and processes, multiple contact points, and limited performance measures and that information was not being shared across locations.	Hasbro consolidated its temporary personnel supplier base to a single provider, reduced the number of oversight personnel, established a formal communication program, and had the contractor assume responsibility for developing consistent policies and processes. Further, by leveraging its buying power, Hasbro negotiated an overhead rate that was 45 percent lower than previously obtained and reduced its total spending on temporary labor from \$5 million to \$4.3 million. A Hasbro official told us its efforts often resulted in savings ranging from 15 percent to 45 percent and improved service levels.
Brunswick	Brunswick conducted a spend analysis to determine the types of telecommunication services its business units acquired, monthly usage rates, and cost data to help it define its requirements and establish a negotiating position. It found its seven business units had three different telecommunication providers.	Following a competition in which six potential suppliers participated, Brunswick awarded a contract to a single supplier. Company officials told us their negotiated per minute usage rates were about 60 percent less than the average of its prior rates, saving Brunswick \$3.2 million in the first 8 months of the new contract.
Dun & Bradstreet	Dun & Bradstreet’s spend analysis showed that the company employed hundreds of providers of temporary labor. While Dun & Bradstreet originally planned to reduce the supplier base to a single provider, its market research found that no one company could meet its needs.	Dun & Bradstreet revised its acquisition strategy to designate a preferred supplier that would receive 70 percent of its business and the contract with a limited number of second tier suppliers that would provide personnel with specialized skills or provide labor to areas not served by the preferred supplier. Company officials told us this strategy enabled them to acquire more actual labor per dollar since the preferred supplier agreed to charge a lower profit and overhead rate than it had previously done when it had a smaller portion of Dun & Bradstreet’s business.
EDS	Prior to implementing its centralized process for procuring information technology services, a spend analysis revealed that EDS had more than 3,000 “unleveraged” suppliers.	EDS initially conducted a strategic sourcing exercise to better define its needs and establish a more manageable number of suppliers and instituted various interim process changes. EDS’ long-term solution was to develop an integrated, web-based, financial and management information system capable of systematically matching its business managers’ needs with potential service providers; capturing spending, wage, and overhead data by skill set and supplier; assessing supplier performance; and performing various financial management and accounting tasks. EDS officials told us that it has reduced its supplier base to 14 national suppliers, 6 regional suppliers, and a small set of providers of personnel with specialized skills, and it typically negotiates overhead rates that are at least one-third less than the industry average. ^a EDS officials estimated they had saved more than \$210 million over the past 5 years by pursuing a more strategic approach to purchasing information technology services.

^aAccording to EDS officials, its system contains cost data on more than 20 million labor hours, to which data on an additional 500,000 to 600,000 hours are added monthly. EDS officials indicated that the ability to track and analyze the types of skill sets acquired, from whom and at what price, provides EDS an ability to aggressively negotiate future labor and overhead rates with service providers.

Source: GAO analysis.

Company officials told us spend analyses can vary in the degree and type of information provided. At a minimum, a basic spend analysis should identify

- what types of services are being acquired;
- how many suppliers for a specific service the company is using;
- how much they are spending for that service, in total and with each supplier; and
- which units within the company are purchasing the services.

Some companies augmented this basic information with more detailed data, such as the number of labor hours purchased, the hourly wage rate paid, and the amount of overhead paid.

Preparing an initial service spend analysis was challenging. Company officials told us their existing financial or management information systems generally did not provide the right type of data needed to manage service spending. As one official explained, the systems were designed to provide detailed information on the components and raw materials that were used to make their products but often provided only scant information on services. For example, officials at one company noted that their systems often reported only a service provider's name and the total cost of the effort, but they did not identify the type of service acquired or key cost elements of the service, such as the number of labor hours supplied, the type or category of labor acquired, and the cost per hour of the labor. Further, this information was often not maintained in a standardized format and was of poor quality, thus hampering efforts to use existing information to more effectively manage service spending. Consequently, companies had to spend months collecting, validating, and analyzing data extracted from their financial or other management systems. Officials from one company noted that they spent about 3 months analyzing data provided by their accounts payable and purchasing systems, and at times, had to review individual purchase orders to prepare a spend analysis for just one of their business units. Even after analyzing individual purchase orders, they had to make educated guesses as to the most likely service the company was buying.

Officials from the companies we spoke with indicate that they have developed, or are in the process of developing, management or financial information systems that can provide them reliable spending data in a timely fashion. These officials stated they now use spend analyses as part of their process to identify additional targets of opportunity, measure

compliance with preferred supplier agreements, respond to customer input, and track progress toward meeting annual performance objectives.

Creating Structure, Processes, and Roles to Support an Enterprisewide Perspective

The companies we studied found it necessary to change how they acquired services, principally in terms of business processes, organizational structures, and roles and responsibilities. These changes were meant to take the companies from a fragmented approach to doing business to one that was more coordinated and strategically-oriented. The end goal was to institute an enterprisewide perspective—one that would ensure that the company was getting the best overall value. Among other changes, each company elevated or expanded the role of the company’s procurement organization; designated commodity managers to oversee key services; and made extensive use of cross-functional teams to help identify the company’s service needs, conduct market research, evaluate and select providers, and manage performance. Table 5 illustrates how these changes affected the role of purchasing in the companies we studied compared to the traditional way of doing business.

Table 5: The Changing Role of Purchasing in Leading Companies

Traditional	Strategic
Independent, local organizations with limited visibility over the company’s total service spending.	Central/matrixed organizations responsible for coordinating or managing service purchases.
Reactive support role to business units.	Proactive business relationships.
Limited coordination between business and purchasing units and other functions such as legal or finance.	Procurement process based on cross-functional teams.
Buyers.	Commodity/service experts.

Source: GAO analysis.

In making such changes, the companies positioned themselves to more effectively manage and coordinate their service purchases. These changes transformed the role of their purchasing units from one focused on mission support to one that was strategically important to the company’s bottom line. For example, Dun & Bradstreet officials told us that, with the support of senior corporate management, their procurement function now exercises far more control and responsibility over services that traditionally had been the responsibility of the business units. These officials indicated they often now act in a proactive advisory capacity to their business units, rather than just being relied upon for their sourcing and negotiating expertise.

Elevating Procurement Organizations

To cut across traditional organizational boundaries that contributed to the fragmented approach to acquiring services, the companies we visited generally restructured their procurement organizations, typically assigning the organizations greater responsibility and authority for strategic planning and management and oversight of the companies' service spending. As table 6 illustrates, making this change was seen as critical to improving coordination and optimizing resources.

Table 6: Examples of How Leading Companies Restructured Their Procurement Organizations

Company	How the companies restructured their procurement organization
Brunswick	Historically, Brunswick had allowed its business units to operate fairly independently, with the corporation acting more like a holding company. According to Brunswick officials, this decentralized structure inhibited its ability to conduct an enterprisewide assessment of its procurement processes and effectiveness. Brunswick's new chief executive officer believed a more coordinated and cooperative approach would help rationalize Brunswick's supplier base and leverage the company's buying power. Consequently, Brunswick established a corporate procurement organization to provide strategic planning for and policy and guidance to its business units and elevated the role of procurement to the vice-presidential level within its corporate structure.
ExxonMobil	Senior corporate leadership took the opportunity presented by the 1999 merger of Exxon and Mobil to develop a procurement organization that would provide the company's 11 business units a competitive advantage by fully optimizing their supply chain through strategic sourcing of key services and gain operating cost efficiencies through a fully integrated procurement and payment process. The president of ExxonMobil's global services company reports directly to an executive vice president.
EDS	EDS employed an informal, decentralized system for obtaining the services of programmers, systems analysts, and other information technology professionals employed on a temporary or contract basis. This system provided managers in the field almost complete authority, but it provided EDS management with only limited visibility over the costs, performance, and value of the services acquired. In the mid-1990s, EDS faced increasing expenditures for labor services needed to meet its client needs. Additionally, in 1998, the chairman challenged the company to reduce its costs by \$1 billion and looked for the corporate procurement organization to contribute significantly to this goal. While the procurement organization previously had been two to three layers from the chief executive officer, the new procurement organization now reports directly to the chief financial officer. Additionally, EDS established a separate unit specifically responsible for developing, managing, and executing a comprehensive sourcing and supply process for acquiring information technology professionals, which EDS officials estimated represented approximately one-third of the services it acquired.

Source: GAO analysis.

Establishing Cross-Functional Procurement Processes

The companies we visited generally established new processes for conducting tasks typically encountered during any procurement action, such as identifying needs and evaluating potential service providers. Most importantly, the companies began making extensive use of "cross-functional" teams to make sure they had the right mix of knowledge,

technical expertise, and credibility.⁴ The teams varied in size but generally included representatives from the company's purchasing unit, its internal clients or users of the service, and its budget or finance office. The teams were responsible for analyzing spending data, identifying and prioritizing potential opportunities for more detailed review, defining internal needs and requirements, and conducting market research. This approach helped companies to better define their needs and to identify, select, and manage service providers, and in turn, helped ensure that users' needs were met at the lowest total costs to the companies. Table 7 provides two examples of companies' cross-functional procurement processes.

Table 7: Examples of Leading Companies' Cross-Functional Procurement Processes

Company	How the companies use their cross-functional procurement process
ExxonMobil	ExxonMobil, the largest company we visited, established a formal procurement process. ExxonMobil officials noted their processes are detailed in a sourcing handbook that is intended to be both practical and flexible enough to provide the basis and support for innovative sourcing strategies. The handbook provides both general guidelines and specific procedures and includes a suite of tools, templates, and checklists needed to effectively conduct sourcing activities. ExxonMobil uses a four-phase, data-driven procurement process (opportunity identification, strategy development, strategy execution and supplier selection, and relationship management) that involves close interaction with the procurement function, internal clients, and suppliers. Sourcing strategy development is integrated within the business units' annual and long term planning cycles to ensure that the strategies, priorities, and cost reduction objectives are fully aligned.
Hasbro	Hasbro begins its procurement process almost a year in advance, using a team-based approach to identify 12 to 15 opportunities each year for a more comprehensive review. According to a Hasbro official, about 30 people—representatives from purchasing, finance, logistics, and affected business units—participate in this exercise and consider, among other things, Hasbro's total spending for that service, the significance of the service relative to Hasbro's principal product lines, and market conditions. Once these opportunities are identified, smaller cross-functional teams are formed to conduct more in-depth analyses. These teams initially focused their activities on identifying Hasbro's requirements and conducting market research; however, the teams subsequently obtained and evaluated information from potential suppliers, conducted negotiations, and finally selected the suppliers. A team member is generally designated to monitor the supplier, in part, as a means to provide feedback into the planning cycle.

Source: GAO analysis.

Establishing Dedicated Commodity Managers

Several companies established full-time dedicated commodity managers to provide more effective management over key services, which were generally described as those being of high-dollar value or those that had a significant impact on the company's operations. ExxonMobil, for example, has eight commodity managers responsible for groups of related materials

⁴ For additional information on cross-functional teaming at DOD, see *Best Practices: DOD Teaming Practices Not Achieving Potential Results* (GAO-01-510, Apr. 10, 2001).

or services, such as mining and drilling services, transportation, information technology, advertising, and promotion. Similarly, Brunswick has established five positions to provide a more strategic and coordinated approach for key services, including telecommunications and information technology services. According to Brunswick officials, these managers will serve both as process and commodity experts to coordinate Brunswick's service purchases as well as change agents to further reengineer Brunswick's procurement processes. Merrill Lynch's commodity managers are expected to be actively involved in defining requirements with its internal clients, negotiating with potential service providers, and assisting in resolving performance or other issues arising after a contract is awarded.

Enabling Success Through Sustained Leadership, Communication, and Metrics

The companies we studied found that three ingredients were critical to overcoming resistance, cultural barriers, and other impediments to their reengineering efforts: sustained leadership, communication, and measurement. Table 8 illustrates how these characteristics differed from when the companies were pursuing a traditional approach to purchasing services.

Table 8: Characteristics Promoting Successful Strategic Reengineering Efforts

Traditional	Strategic
Corporate leaders not actively engaged in improving service acquisitions.	Senior leaders actively reinforce commitment to achieve change.
Business units and purchasing organizations do not clearly communicate or cooperate.	Clear lines of communication between all affected parties.
Performance measures did not exist.	Performance measures used to demonstrate value and credibility of new processes.

Source: GAO analysis.

First, company officials reiterated the need to have the continued support of senior management, well beyond just providing the initial impetus for making changes to service acquisitions, since the companies were engaging in long-term efforts. Specifically, they noted that senior managers need to continually back efforts to develop common processes and approaches and provide the necessary clout to push for acceptance of reengineering efforts.

Second, communication was viewed as vital to getting and keeping staff on board with changes. Company officials explained that up until the

reengineering effort, the business units and purchasing organizations generally did not clearly communicate their needs or work together to identify solutions; consequently, working together represented a new and potentially challenging way of doing business. To achieve buy-in and avoid unforeseen pitfalls, reengineering teams needed to make a compelling case for change and clearly communicate the rationale, goals, and expected results from the new processes or practices. Companies also found that it was important that their reengineering teams listen to their business units' and other affected parties' needs and concerns and be open to revising plans as appropriate. Doing so helped ensure that the changes did not undermine their managers' ability to produce results, but rather enhanced their ability to carry out their work in terms of (1) more timely delivery of needed services, (2) the hiring of better skilled or trained consultants, (3) reduced costs, or (4) providing an alternative solution to meet their needs.

Third, while used to various degrees, metrics, according to company officials, increased the likelihood that reengineering efforts would be successful. In general, metrics can be used to

- evaluate and understand an organization's current performance level;
- identify the critical processes that require focused, management attention;
- obtain the knowledge needed to set realistic goals for improvement; and
- document results over time.

Companies typically measured total savings, cost avoidances, or some other financial measure, which were often reported to senior corporate officials. For example, Dun & Bradstreet officials told us that measuring savings is a key element of their procurement process. Consequently, senior company management sets targets for its procurement function at the beginning of the year and regularly reviews progress reports.

Because most companies expanded the traditional role of the procurement function, several companies surveyed their business units to assess their satisfaction with the quality, timeliness, and value of the service provided by their procurement organization. For example, ExxonMobil employed an extensive, three-tiered system to measure the performance of the procurement function. Specifically, it established eight top-level metrics to assess the procurement organization's progress in meeting financial, customer satisfaction, and business operation objectives. A second tier of metrics is used for performance monitoring and internal/external benchmarking, while a third tier is used at the local site level to manage day-to-day activities, including compliance with best practices. Company

officials also noted that the measurements needed to be credible to prevent disagreements over numbers that could undermine the value of the process itself.

Company officials also cited the need to measure compliance with or use of the new processes, especially when in the initial stages of the reengineering effort, since the extent to which business units use a new, lower cost approach directly affected cost savings. For example, EDS officials told us that about half of the information technology services are acquired using their new procurement process. They are monitoring the degree to which business managers use the process as it is introduced in their units. EDS estimates that, if business managers meet the company's target of 70 to 80 percent of usage by the end of 2001, the company would save an estimated \$26 million.

Strategic Approach Could Serve As a Framework to Guide DOD's Service Contracting Initiatives

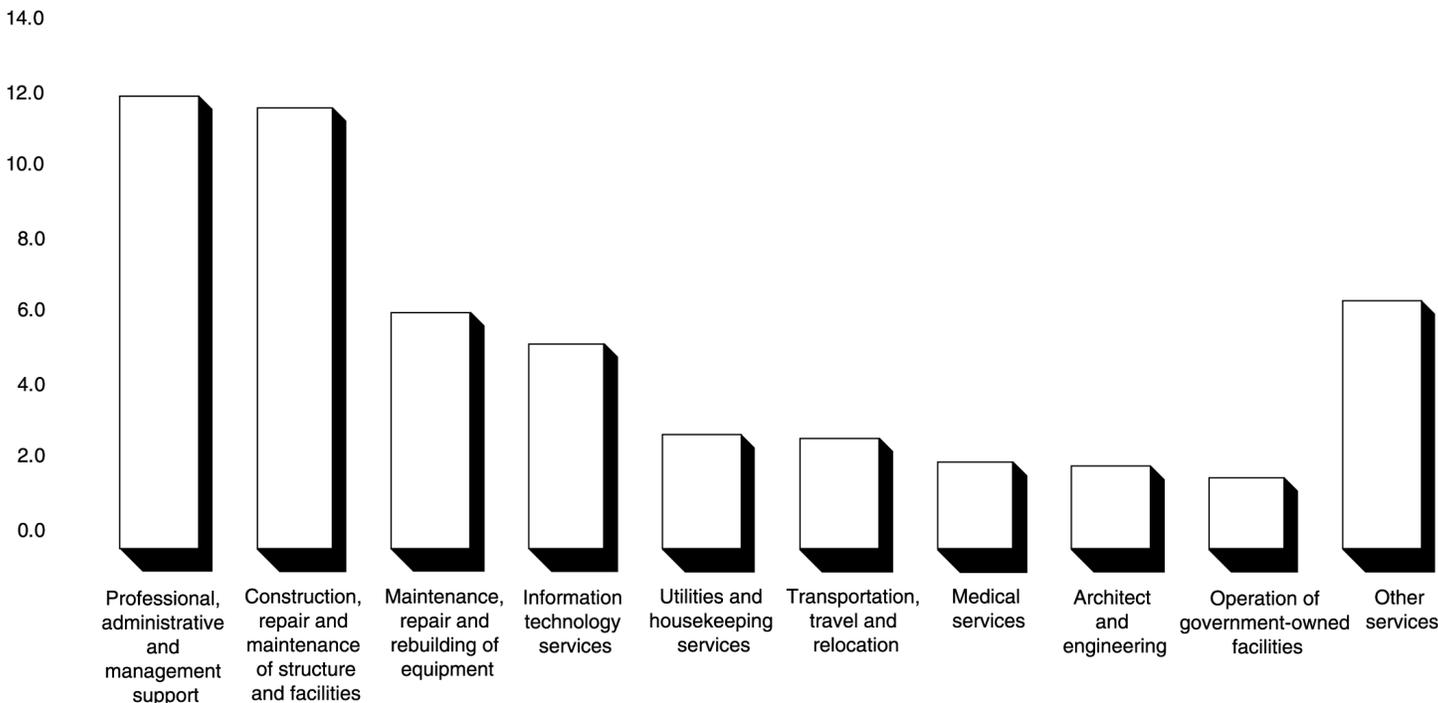
Senior DOD leadership has recognized the need to improve its processes for acquiring services, especially as it increasingly relies on the acquisition of services to meet its needs. However, DOD lacks a strategic plan that integrates or coordinates the various initiatives underway within the Department or that provides a road map for identifying or prioritizing future efforts. In this regard, the strategic approach followed by the leading companies we visited could serve as a general framework to guide DOD's service contracting initiatives. DOD may find that a "one-size-fits-all" approach will not work and that it will need to tailor its approach to meet its specific needs and requirements. In doing so, DOD officials will need to consider DOD's size and the range and complexity of the services it acquires, address the existence of insufficient information and financial systems, and take into account the unique aspects of the federal acquisition environment.

DOD Leadership Recognizes That Changes Are Needed

DOD leadership has recognized the need to change DOD's current practices for acquiring services. In January 2001, DOD's Under Secretary of Defense (Acquisition, Technology, and Logistics) noted that while DOD was making important strides in improving the quality of services acquired, DOD had not achieved the level of excellence and consistency that it needed to meet its needs. Further, in his annual report to the President and the Congress for 2001, the Secretary of Defense noted that DOD is working to adapt the same "revolutionary business and management practices that helped the commercial sector gain a competitive edge in a rapidly changing global marketplace."

The need for change is due in part to the increasing role that services play in DOD. Over the past decade, DOD's total purchases declined considerably as the end of the Cold War led it to reduce its purchases of supplies and equipment. During this period, however, DOD's purchases of services rose by more than 16 percent in real terms, largely attributable to increased purchases of information technology services and professional, administrative, and management support services. Consequently, in fiscal year 2000, DOD purchased about \$53.1 billion in services, roughly the same amount it spent on supplies and equipment. Figure 3 shows where DOD's service contracting dollars went in fiscal year 2000.

Figure 3: Services Purchased by DOD in Fiscal Year 2000 (dollars in billions)



Source: GAO analysis of data extracted from the Federal Procurement Data System for actions exceeding \$25,000. Figure excludes actions categorized as research, development, test and evaluation activities.

While senior DOD leadership has called for dramatic changes, DOD currently operates much like the companies we visited operated before they adopted a strategic approach. For example:

-
- Responsibility for acquiring services is spread among individual military commands, weapon system program offices, or functional units on military bases, with little visibility or control at the DOD- or military-department level.
 - DOD has an information system that can provide information on the amount spent on services, but the reliability of the information is questionable and the system itself is seldom used as a tool to manage or identify opportunities for managing DOD's supplier base.
 - Procurement processes within DOD are not always carried out efficiently and effectively. Our work, as well as that of other oversight agencies, continues to show that requirements are not clearly defined for many service contracting efforts, alternatives are not fully considered, vigorous price analyses are not performed, and contractors are not adequately overseen. For example, last year, we raised concerns that DOD has avoided competition when acquiring services, and the DOD Inspector General found that DOD had not adequately performed many basic management tasks, including market research, pricing analyses, and contractor surveillance. Such problems contributed to our decision to designate contract management as a high-risk area for DOD.⁵
 - There are few service contracting-related enterprisewide annual performance metrics. For example, DOD's key metrics for measuring changes to its contracting processes include (1) the percentage of purchases made by purchase card, (2) the percentage of paperless contracting and payment transactions, and (3) the percentage reduction in acquisition workforce personnel.⁶ These metrics do not measure the cost effectiveness or quality of services obtained.

DOD Does Not Have a Strategic Plan for Addressing Service Contracting Issues

DOD and individual defense components have various initiatives underway to better manage their acquisition of services, including expanding the use of performance-based contracting approaches. However, DOD does not have a strategic plan to coordinate current service contracting initiatives or to serve as a road map for identifying or prioritizing future efforts.

⁵ *Major Management Challenges and Program Risks: Department of Defense* (GAO-01-244, Jan. 2001).

⁶ DOD is also measuring the percentage of service contracts awarded that are considered to be performance-based, but this metric is not included as one of DOD's annual performance goals.

From a departmentwide perspective, DOD, like other federal agencies, is expanding the use of performance-based contracting approaches to help improve its processes for acquiring services. Performance-based contracting is an approach where the agency specifies the outcome or result it desires and lets the service provider decide how best to achieve the desired outcome. The government has not widely used this process, but it is attempting to do so to attract leading commercial companies, gain greater access to technological innovations, and better ensure contractor performance. To support this initiative, DOD has issued a guidebook and is providing additional training to its acquisition personnel. Additionally, in January 2001, DOD chartered a senior-level team to identify best practices, guidance, training, and additional policy needs for service contracting.⁷ This team has focused its initial efforts on drafting policy to provide better oversight on purchases of high-dollar value services.⁸

Additionally, officials from the military departments noted that their commands are pursuing a number of service contracting-related initiatives. The Naval Supply Systems Command, for example, is establishing commodity managers for selected supplies and services being purchased via electronic procurements. The Naval Sea Systems Command is developing an electronic procurement system for acquiring professional services, such as for financial management and logistics support, for the command's headquarters. Air Force officials noted that they are considering creating a position at the senior executive service-level that would have specific responsibility for developing policy, reviewing acquisition strategies for high-dollar value services, and providing general oversight of the Air Force's spending on services. Army officials noted that they are evaluating how to centralize the processes for acquiring services within the Office of the Secretary of the Army.

While DOD officials pointed to these initiatives as attempts to address various service contracting needs and issues, they acknowledged that

⁷ DOD's Services Acquisition Integrated Process Team is co-chaired by the Deputy Under Secretary of Defense (Acquisition Initiatives) and the Director, Acquisition Resources and Analysis and includes senior representatives from each of the military departments, the General Counsel's office, and offices responsible for DOD's military installations, environmental security, contract policy, information technology, and small business issues, respectively.

⁸ DOD officials also identified DOD's TRICARE health care program and its efforts to reengineer its acquisition of travel and transportation services as efforts to better manage services from a DOD-perspective.

DOD has not developed a strategic plan to coordinate these initiatives or to provide a road map for identifying or prioritizing future activities. They noted that DOD is just now turning its attention to improving how it acquires services, but they believed that DOD has various elements—including the commitment by senior DOD leadership—in place that could serve as building blocks for taking a more proactive role in managing services.

Developing a Strategic Approach to Meet DOD's Diverse Needs

The strategic approach followed by the leading companies we visited could serve as a general framework to guide DOD's service contracting initiatives. However, DOD may find that a "one-size-fits-all" approach will not work for all services and that it will need to tailor its approach to meet its specific needs and requirements. In doing so, DOD officials will need to consider DOD's size, the range and complexity of the services it acquires, and the existence of insufficient information and financial systems and take into account the unique aspects of the federal acquisition environment.

While company officials stressed the need to take an enterprisewide perspective on acquiring services, DOD's size and service needs may lead it to pursue different approaches depending on the specific service. DOD officials noted that within the military departments, there are individual commands that are comparable to a Fortune 500 company, each spending billions of dollars annually on services. Further, DOD officials noted some services are acquired departmentwide, while other services (such as ship support and maintenance) may be unique to specific commands, units, or geographic locations. DOD officials agreed that they would need, as a first step, to obtain and analyze data on DOD's service spending to identify and prioritize specific services where a more coordinated acquisition approach may be appropriate.

Additionally, DOD will need to consider how existing problems in its information technology and financial management systems could affect its service contracting initiatives. For example:

- DOD's efforts to deploy a single automated system—the Standard Procurement System—to perform numerous contract management-related functions have encountered cost overruns, schedule delays, and performance issues. DOD expected the system to replace legacy systems that supported divergent contracting processes and procedures across component organizations and to provide electronic commerce capabilities and a common data repository.

-
- DOD continues to confront pervasive weaknesses in its financial management systems, hindering its ability to produce timely and accurate financial information needed to make sound business decisions.
 - DOD envisions using electronic commerce technologies to transform and streamline business processes. However, we have reported that DOD's electronic commerce vision is at risk because DOD does not have an architecture, or common blueprint, that is essential for effectively introducing modern electronic commerce operations.⁹

Lastly, as a federal agency attempting to reengineer its approach to purchasing services, DOD faces challenges that private sector organizations do not face. In particular, DOD is subject to statutes and regulations governing socio-economic objectives, competition, and contracting procedures. Under existing statutes and regulations, for example, DOD is subject to goals for contracting with small businesses and may be constrained in its ability to consolidate numerous, smaller requirements into larger contracts, an approach often taken by the companies we visited. Consequently, DOD will need to consider how to adapt the practices followed by leading companies to the unique federal environment.

Conclusions

The leading companies we visited chose to institute dramatic changes to the way services were purchased and managed instead of only making incremental improvements and continuing to treat services as being peripheral to the bottom line. While difficult and challenging to carry out, companies pursued a strategic approach because it was viewed as essential to staying competitive. DOD leaders have already made a general commitment to adopt best practices and make dramatic changes. With this commitment in place, they can take on the more difficult tasks of developing a reliable and accurate picture of service spending across DOD; determining what structures, mechanisms, and metrics can be employed to foster a strategic approach; and tailoring those structures to meet DOD's unique requirements.

Recommendation for Executive Action

To achieve significant improvements across the range of services DOD purchases, we recommend that the Secretary of Defense evaluate how a strategic reengineering approach, such as that employed by the leading

⁹ *High Risk Series: An Update* (GAO-01-263, Jan. 2001).

companies we visited, could be used as a framework to guide DOD's reengineering efforts. Specifically, the Secretary of Defense should assess whether

- current or planned financial or management information systems can provide the type of spending data that DOD needs to identify opportunities to leverage its buying power, reduce costs, and provide better management and oversight of its suppliers. Such data would include what types of services are being acquired; how many suppliers are being used for specific services; and how much DOD is spending on specific services, in total and with each supplier.
- DOD's current organizational structure, processes, and roles are adequate to support a more strategic approach to acquiring services; for example, whether cross-functional teams would improve the coordination and management of service acquisitions and whether it would be beneficial to establish full-time dedicated commodity/service managers to provide more effective management of key services.

Agency Comments

In commenting on a draft of this report, DOD concurred with the views expressed in the draft report. DOD noted that it was committed to taking a more strategic approach to acquiring services as well as developing an oversight process for the acquisition of services. DOD also provided informal technical comments, which we incorporated as appropriate.

Scope and Methodology

The Chairman and the Ranking Minority Member, Subcommittee on Readiness and Management Support, Senate Committee on Armed Services, requested that GAO develop a body of work that examines the practices of leading companies and identify "best practices" that could yield benefits to DOD. This assignment focused on (1) how leading companies reengineered their practices for acquiring services and (2) the extent to which DOD is pursuing a similar approach.

To identify the best practices in the commercial sector, we conducted literature searches and contacted universities, industry associations, research organizations, and experts in purchasing practices. On the basis of these discussions and analyses, we selected several leading companies that were recognized for their purchasing practices for buying services. We provided a standard agenda to each company to obtain general information on its organizational structure; the role, structure, and nature of its purchasing organization; the process by which it determined its service needs; and the way the company selected, managed, and evaluated

service providers. We also asked each company to discuss in more detail a specific service buy that best exemplified its reengineered purchasing practices. After our visits, we provided a summary of the information obtained to ensure that we had accurately recorded and understood the information each company provided. We also provided each company a copy of our draft report for review and comment. The companies we visited were

- Brunswick Corporation, Lake Forest, Illinois;
- The Dun & Bradstreet Corporation, Murray Hill, New Jersey;
- Electronic Data Systems Corporation, Plano, Texas;
- ExxonMobil Corporation, Fairfax, Virginia;
- Hasbro, Inc., Pawtucket, Rhode Island; and
- Merrill Lynch & Co., Inc., Jersey City, New Jersey.

To assess what lessons can be drawn from these companies' experiences to guide DOD's efforts, we interviewed officials within the Office of the Secretary of Defense and the military departments to determine what efforts they had underway to improve the acquisition of services. We also reviewed policy memoranda, guidance, and other documents pertaining to ongoing and planned initiatives that affected service contracting. We discussed with these officials our assessment of the leading companies' approaches and obtained their views on their approaches similarities and differences. We also asked them about potential barriers to employing the approaches we identified. We plan to evaluate how specific best practices could be adopted or adapted for use by DOD on future assignments.

Our report summarizes the approaches and key elements that the companies employed to reengineer their purchasing practices for services. We did not intend to suggest that all companies have followed the same approaches or to imply that other approaches could not be taken to achieve similar results. Also, we were limited in our ability to obtain and present some relevant data that companies considered proprietary in nature. Due to the competitive nature of their businesses, the companies did not wish to release details of how their reengineered purchasing practices resulted in specific successful outcomes.

We conducted our review from June 2000 to December 2001 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Secretary of Defense; the Secretaries of the Army, Navy, and Air Force; the Director, Office of Management and Budget; the Administrator, Office of Federal Procurement Policy; and interested congressional committees. We will also provide copies to others on request.

If you have any questions about this report or need additional information, please call me on (202) 512-4841. Key contributors to this report are listed in appendix II.

A handwritten signature in black ink, appearing to read 'J. Brock, Jr.', with a long horizontal flourish extending to the right.

Jack L. Brock, Jr.
Managing Director
Acquisition and Sourcing Management

Appendix I: Comments From the Department of Defense



ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

January 16, 2002

Mr. Jack Brock
Managing Director
Acquisition and Sourcing Management
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Brock:

Attached is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report GAO-02-230, "BEST PRACTICES: Taking a Strategic Approach Could Improve DoD's Acquisition of Services," dated December 12, 2001 (GAO Code 120031). The Department concurs in the views expressed in the GAO draft report; however, specific comments concerning your report are attached.

Sincerely,

A handwritten signature in cursive script that reads "Donna S. Richbourg".

Donna S. Richbourg
Director, Acquisition Initiatives

Attachments:
As stated



GENERAL ACCOUNTING OFFICE DRAFT REPORT
DATED December 12, 2001
(GAO CODE 120031)

“BEST PRACTICES: Taking a Strategic Approach Could Improve DoD's Acquisition of
Services”

DOD COMMENTS IN RESPONSE TO THE GAO RECOMMENDATIONS

RECOMMENDATION: The GAO recommended that the Secretary of Defense expand the current charter of the senior-level integrated process team to include evaluating and reporting on how a strategic reengineering approach, such as that employed by the leading companies we visited, could be used as a framework to guide DOD's reengineering efforts. Specifically, the team should be tasked to assess whether

- current or planned financial or management information systems can provide the type of spending data that commercial companies believed were critical to identify opportunities to leverage their buying power, reduce costs, and provide better management and oversight of their suppliers. Such data would include what types of services are being acquired; how many suppliers are being used for specific services; and how much DOD is spending on specific services, in total and with each supplier.
- DOD's current organizational structure, processes, and roles are adequate to support a more strategic approach to purchasing services; for example, whether cross-functional teams could be used to coordinate and manage service purchases and whether DOD could establish full-time dedicated commodity/service managers to provide more effective management over key services.

DOD RESPONSE: Concur. The Department is committed to taking a more strategic approach to the acquisition of services. In that regard, DoD is already implementing plans to upgrade the Federal Procurement Data System to provide more detail on service acquisitions. The upgrade will include all those elements required by Section 801 of the FY2002 National Defense Authorization Act. As the GAO report accurately states, DoD is developing an oversight process for the acquisition of services. One of the principal purposes of that oversight process is to ensure that acquisitions of services are clear in their requirements, are properly planned, and that desired outcomes are identified and can be measured.

Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

Ralph Dawn (202) 512-4544

Acknowledgments

In addition to those named above, Cristina Chaplain, Timothy DiNapoli, Gordon Lusby, Ronald Schwenn, and John Van Schaik made key contributions to this report.

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