

Assessment of Government "Commercial Activities" and Opportunities for Outsourcing and Privatization¹

June 18, 2001

This paper was prepared for the Commercial Activities Panel established by Section 832 of the National Defense Authorization Act of 2001 (Public Law 106-398), to help aid the panel's discussion and search for appropriate alternatives to the existing procedures for transfer of commercial activities.

EXECUTIVE SUMMARY

There is a solid *case for action* to move numerous existing federal activities to the private sector. The reasons for this are many and complex, and include the need to make room for new challenges that can best be addressed by government, but for which the government does not now have the resources.

This is not a simple undertaking, and given the potential for change over the next few years across all levels of government and between the public and private sectors, it is a matter of national importance. Doing it wrong could be more costly than not doing it at all.

Given the passions that exist on all sides of the debate and the need to truly make progress, it is recommended as a first course of action, that the Commercial Activities Panel establish a set of operating principles as a framework to guide the actions of federal agencies.

The development of the principles should be based on a decomposition of the issues raised throughout the Panel's public hearing process. A set of eight such principles is provided here to illustrate the approach recommended and to stimulate the discussion:

1. Agencies should address their plans for commercialization in their GPRA submissions.
2. Agencies should encourage their internal administrative and commercial-type activities to operate on a fee-for-service basis.
3. Agencies operating on a fee-for-service basis should comply with OMB's 12 Operating Principles.
4. An agency should be designated to administer a central information program on best practices, lessons learned, and the like.
5. Agencies should be encouraged to either have a fully operable finance system within two

years or be encouraged to purchase that service from someone else.

6. In the award of service contracts, agencies should be guided by the premise that it should result in "the best deal for the taxpayer."
7. Any agency may bid on any initiative identified in the Commerce Business Daily, and any private sector firm may bid on work being performed under an interagency support agreement.
8. OMB should design a framework for involving public-private sector competitions that reasonably "levels the playing field."

CASE FOR ACTION

Moving activities from the government to the private sector "clears the deck" for federal agency resources to be used to address increasingly new challenges in such areas as health care, information security, the environment, trade, education, poverty, and international terrorism.¹

Importantly, it can also be argued that it would be a good use of existing resources to simply address the egregious management problems that have already been identified by both the General Accounting Office in its major management challenges list² and most recently in Senator Fred Thompson's 2-volume report "Government at the Brink."³

There is literally more work for government to do than the resources available. It only makes sense that it shed some of these responsibilities in some responsible way. The drivers for change are many, and include:

- Changing communities and their needs,
- Changing organizations and fiscal pressures,
- Sophisticated and demanding customers,
- Changing workforce,
- Perceptions of waste and inefficiency, and
- New technologies.⁴

Regarding the use of new technologies, NAPA President Bob O'Neill remarked at a

¹ This point was discussed extensively in Peter Drucker's article "Management's New Paradigm," *Forbes*, October 5, 1998.

November 2000 federal, state, and local conference on 21st Century Governance:

"We have the opportunity to transform our organizations, and redefine relationships among the levels of government and across sectors."⁵

In addition to these considerations, there are the legal implications of the *Clinger-Cohen Act*, which require that federal agencies make a "determination" as to where the work can be best done before undertaking any significant information technology initiative.

BACKGROUND

Not everyone in government wants to outsource, but everyone in the private sector seems to want to do it. Why is that? There are at least three important perceptions that shape these discussions:

1. That the A-76 process is too burdensome to deal with.
2. That contractors are just after the money.
3. That the private sector is better equipped to provide services than the government.

That the A-76 process is too burdensome to deal with

There are probably only a few supporters of OMB Circular A-76, and many in government are stymied by their perception of the overburdening *process* that it requires to be implemented. This doesn't have to be the case, however, and it is a fact that an "A-76" study was done in less than a month for the Federal Aviation Administration's \$250 million ICE-MAN contract that was awarded to the USDA's Kansas City data processing center. And, ICE-MAN was not an initiative that slipped by under the "radar screen."

"When the Government Hires the Government"
—*Washington Post*, 5/22/97

"FAA: ICEMAN goes to the White House"
—*Federal Computer Week*, 6/2/97

The ICE-MAN A-76 study was reviewed and accepted by both OMB and the GAO and there were no industry protests.⁶ *Leadership* was a key factor in the success of the ICE-MAN initiative,

and the project has been a success as determined in repeated customer satisfaction surveys.

Almost everyone agrees that A-76 could be better. How to revise it seems to be the major question and few offer suggestions except to say, "scrap it." The A-76 proviso for reengineering a government entity into its "most efficient organization," however, seems to have wide support, and it is part of the reasoning behind the contention that merely going through the process enhances the efficiency and effectiveness of the organization. This kind of thinking has origins in Total Quality Management, Business Process Reengineering, and other accepted practices and should be encouraged whether A-76 exists at all.

That contractors are just after the money

Some contractors doubtlessly would be interested in seeing more government contracts awarded to the private sector, although with our low rate of unemployment, it's not clear where the workers would come from. To meet the demand, the private sector has had to bring foreign workers into the United States on special visas. Moving contract efforts off shore has not been sufficient.

Some contractors assume that they will address their staff shortages by just moving the government employees into the private sector. It's not clear that this is in the public's best interest, since skilled staffs are still needed by the government.

No, not all contractors are after the money. Some believe that government just can't do the work well and that federal tax dollars are being wasted. One former head of a national trade association stated his belief that if the USDA data center that won ICE-MAN had the excess capacity to bid on the job, then it should have "RIFFED" the staff down to the operational level that it needed and not been allowed to bid on the contract. There are two critical federal needs that this kind of thinking opposes:

1. A federal organization cannot RIF (Reduction in Force) employees every time it has excess capacity. Workforce retention necessitates that there be some employee stability. It is not uncommon for a downsized organization to be hit with a new legislative requirement and have to restaff. Private sector consulting firms note these temporarily unemployed persons as being "on the beach." In most cases, the firms

would rather have them "on the beach" for a while than incur a negative reputation as being a "body shop."

2. The notion of retaining and maintaining "intellectual capital" has been addressed extensively by the Comptroller General, OMB, the Congress, and many others. The federal government must retain the skills needed to manage and oversee its contracts and operations. Increasingly, *centers of excellence* such as the USDA center in Kansas City will serve this purpose. They should be identified and nurtured.

That the private sector is better equipped to provide services than the government

The federal government is often at a major disadvantage when providing services, and there are several reasons for this. At the May 11, 2001 hearing of the Commercial Activities Panel, one member asked how the private sector provided cheaper services. The answer was that companies were able to leverage across skill sets developed around their specific areas of expertise, i.e., they were *centers of excellence*.

There are additional factors, however. And, one of the most important is the nature of the contractual relationship. That is, you get paid for the work you do. This simple principle has an amazing effect, as has been found out by federal agencies who increasingly have turned away from living off a direct appropriation to living off the fees for their services.

Contracted efforts often become cheaper because the contractor and the government set up a process whereby the government must pay the contractor for the services it wants. If the services were free—as they are in fully appropriated activities—then there would be no end to the requests that are made and everyone is frustrated. Most often in trying to provide free service to everyone, the organization winds up providing no service to anyone.

When a service runs less expensively in the private sector than in government, you need to look behind the scene as to why. It may be because the same set of controls and service levels are not the same as they were when the government ran the effort. And, of course, there may be other reasons as well.

It should be agreed from the outset that both sectors have areas of excellence and areas in

which they can improve. In the private sector, for example, the Fall 1997 *Sloan Management Review* pointed out that U.S. corporations spent almost \$3 trillion dollars a year in "indirect services" such as data processing, with 80 percent of the purchases being negotiated without any formal purchasing process. The federal government could never get away with this!

The article further pointed out that a 15 percent reduction in these costs could raise profits by as much as 50 percent. While GE's Jack Welch and other CEOs were beginning to jump on this opportunity, their line managers sounded a lot like federal managers saying that they lacked the skills to compete, oversee, and administer the contracts for these indirect services. They said their companies applied the *talent* to its principal lines of business.

WORKING TOWARDS A SOLUTION

In the 18th century, the British reportedly hired Hessian mercenaries for a per diem wage. If they sat down on the job, they still got paid. The Continental Congress, on the other hand, had privateers who were paid with a percentage of what they captured. Result? The British focused on how many troops they were paying (i.e., inputs), rather than how many ships/forts were being captured/destroyed (outputs) and campaigns won (i.e., outcomes). We are smart when we tie incentives to the *outcomes!*⁷

The point of this is that no matter what we do, if we don't do it wisely, our expectations will not be met. Similarly, either revising the A-76 process or canceling it outright without a viable substitution seems to be short-sighted.

Given the tremendous change potential of governance in the 21st century, it may be beneficial to approach the Panel's challenge in much the same way as did the framers of the Declaration of Independence and the Constitution, stating what we believe and what we do not, rather than specifying a detailed process for all. Consider the following:

1. After 211 years federal accounting standards were finally established in 1998 and 80 percent of federal accounting systems will be redone over the next few years. (*Good data supports informed decision-making. Things will get better.*)
2. Federal agencies continue to receive unacceptable grades on their *Government*

Performance and Results Act submissions to the Congress. (There is lots of room for improvement and somebody needs to help them comply with this 1993 requirement.)

3. Federal workforce planning and the management of intellectual capital are among the top concerns of both GAO and the Bush Administration. *(If you are not careful in implementing new policies that affect human resources, you may only exacerbate the situation.)*

NEXT STEPS

When the National Imagery and Mapping Agency began operations, it took a long view at where it wanted to go. This example warrants discussion, because of its significant benefits and risk avoidance potential.⁸

From the top level, the leader can decide on what activities the organization should perform for itself and which to commercialize, where to foster commercial markets where perhaps only a monopoly might now exist, and what research and development to support to enable the agency to attain its vision.

The benefits of this farsightedness should be obvious. With even a few years of lead time, it is possible to usefully retrain/reassign employees and thereby avoid human resource and morale problems, to make the necessary contract and grant arrangements, and to successfully transition to the new organization with the support of employees and their unions as well as the private sector. This is the kind of thinking that NIMA did. The leader at the top has lots of options for getting the job done; the line manager at the bottom has almost none.

Can we agree on a few basic principles that will guide further federal actions, and then let agencies work with them a while to gain the experience needed to then perhaps develop a more formal process if warranted? Isn't it possible that the role of government in the 21st century is in such a transition that we might inappropriately constrain the changes that need to take place? A set of useful principles might include, for example:

1. ***Agencies should address their plans for commercialization in their GPRA submissions.*** *(This gets the issue out in the open and identifies those agencies that need help.)*

2. ***Agencies should encourage their internal administrative and commercial-type activities to operate on a fee-for-service basis.*** *(This gets the pressures on the organization moving in the right direction, while encouraging entrepreneurialism and discouraging the giveaway of services, as a free good Access to a working capital/revolving fund would be helpful.)*
3. ***Agencies operating on a fee-for-service basis should comply with OMB's 12 Operating Principles.*** OMB and the federal Chief Financial Officers' Council established the 12 operating principles jointly. They include provisions for: competition, voluntary exit, self-sustaining/full cost recovery, surge capacity, FTE accountability, initial capitalization, dynamic adjustments, cessation of activity, organization services, performance measures, and benchmarks. *(This is the existing OMB policy, but it does not appear to be enforced.)*
4. ***An agency should be designated to administer a central information program on the topic, distributing information on best practices, lessons learned, and the like.*** DOD has recently established such an effort, but the civil agencies do not necessarily use it. *(This keeps everyone honest and informed on what works and what does not. It would also be helpful if this organization were designated the task of following up to see how well the cost/service realities match the expectations.)*
5. ***Agencies should be encouraged to either have a fully operable finance system within two years or be encouraged to purchase that service from someone else.*** *(Agencies that continue to frustrate themselves and their program managers and employees with an inability to get an appropriate finance system operational should be given the help they need to make it happen.)*
6. ***In the award of service contracts, agencies should be guided by the premise that it should result in "the best deal for the taxpayer."*** This was the position that OMB took during the *FAIR Act* deliberations, and it remains the most appropriate position. It should not matter whether the work is performed by another federal agency or the private sector. *(This keeps the initiative focused and avoids abuses to the procurement process. If the government wants to give work to the private sector even though the government could do it more cost-effectively, then a grant or other mechanism might be more appropriate.)*

7. *Any agency may bid on any initiative identified in the Commerce Business Daily, and any private sector firm may bid on work being issued under an interagency support agreement.* This is now generally the OMB policy, but it is not widely known in this way. (*Competition is good for everyone.*)
8. *OMB should design a framework for involving public-private sector competitions that reasonably "levels the playing field."* This may involve a revision to Circular A-76, and it should provide for the identification of the "full cost" to the taxpayer. The point is that there are certain "puts" and "takes" in the calculations that would be helpful to make when comparing such proposals, and often more "costs" are involved than simply those related to an agency's budget. Work on this issue was funded by the Pricewaterhouse Coopers Foundation for the Business of Government in 1999. (*See "Determining a Level Playing Field for Public-Private Competition," by Lawrence L. Martin, PWC Endowment Grant Report, November 1999.*)

A NOTE ON PRIVATIZATION

Among the most successful privatizations in recent years has been that of the U.S. Investigations Service, which became an Employee Stock Ownership Plan (ESOP). There have also been a number of failures and near-failures.

One of the key lessons learned from the USIS experience has been that the potential for success is higher when those making the transition have business-like experience. That is, they have customers who appreciate their services, they have a defined set of products and know their costs, and they operate on a fee-for-service basis. Notably, these former civil servants have reduced their customers' costs by 25 percent and gained for themselves substantial equity value and bonuses. Last year, they were also in the final competition for the coveted Innovations in American Government Award.⁹

The Commercial Activities Panel is not necessarily in a position to privatize federal activities, but it is in a position to encourage agencies to be more entrepreneurial and business-like in their dealings with each other and with the private sector. Success in this area will pay off well in effective management of commercial activities wherever that responsibility resides, and

it will prepare federal employees to respond with innovation, creativity, and confidence to an uncertain future.

OTHER RESOURCES

- "The Case for Public-Private Partnerships," by Cynthia Rheame, *The Public Manager*, Summer 2000.
- "Entrepreneurial Government: Bureaucrats as Business People," by Anne Laurent, PWC Endowment Grant Report, June 2000.
- "The Company Goes Commercial," by Michael D. Serlin and Timothy B. Clark, *Government Executive*, July 1999.
- *Enterprise Government: Franchising and Cross-Servicing for Administrative Support* by Arie Halachmi and Kenneth L. Nichols, Eds, Chatelaine Press, 1996.

ENDNOTES

¹ Written by Wallace Keene, MBA, CGFM, Managing Partner, Keene Ideas, Inc. Mr. Keene is a co-author of *Positive Outcomes: Raising the Bar on Government Reinvention* (Chatelaine Press, 1999) and has 10 years of private sector management consulting experience and 28 years of public sector experience. During his federal career, Mr. Keene served as chief information officer at HHS and at NASA, and as the NPR's Finance Team, working across agencies to promote a wide range of entrepreneurial activities.

² Comptroller General, *Major Management Challenges and Program Risks: A Governmentwide Perspective*, GAO-01-241 (Washington, D.C.: U.S. General Accounting Office (GAO), January 2001).

³ Thompson, Fred, "Government at the Brink," 2 volumes, available at www.senate.gov/~gov_affairs/vol1.pdf (Volume 2 is same reference except "/vol2.pdf"), June 2001.

⁴ Popovich, Mark G., ed., *Creating High-Performing Government Organizations* (San Francisco, CA: Jossey-Bass, Inc., 1998), p. 14.

⁵ O'Neill, Robert J., Jr., "The Levers of Power," from "21st Century Governance," A Supplement to *Government Technology*, January 2001.

⁶ Keene, Wallace, "ICE-MAN and the Aftermath," *The Public Manager*, Winter 1999-2000.

⁷ Keene, Wallace, "Federal Outsourcing, Part II," *The Public Manager*, Summer 1998.

⁸ Keene, Wallace et al, "Handbook for Selecting Activities for Outsourcing," March 28, 1997. (Prepared under CSC subcontract to SAIC for NIMA.)

⁹ Keene, Wallace O., "What kind of a business model is government taking into the 21st century?" *PA Times*, January 2000.