



## Market-Based Government: Lessons Learned from Five Cases

Title	Market-Based Government: Lessons Learned from Five Cases
Item Type	Book Chapter
Authors	Lucyshyn, William
URI	<a href="https://hdl.handle.net/10945/40252">https://hdl.handle.net/10945/40252</a>
Publisher	PrAcademics Press
Date Issued	2012
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Download date	2026-04-14 04:46:39
Link to Item	<a href="https://hdl.handle.net/10945/40252">https://hdl.handle.net/10945/40252</a>

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## Chapter 6

# Market-Based Government: Lessons Learned From Five Cases

*William Lucyshyn*

### INTRODUCTION

On August 4, 2004, the Internal Revenue Service (IRS) announced that the Media and Publications Division (MPD) would reduce its staffing by 60 percent and close two of its three operating locations. At the same time they anticipated that overall performance would improve. How is that possible? The key is competition.

The MPD was the third largest government publisher in the country. It maintained an inventory of over 21,000 published products and delivered them using traditional paper printing, as well as by fax, CD-ROM, Braille, Internet, Intranet, etc. The MPD maintained three Area Distribution Centers (ADCs) to handle public and internal requests for published products.

With the increasing availability of digital publications, there was a decreasing demand for MPD's paper copies—trend data showed a 6 percent annual decline in workload at the ADCs. For this reason the IRS chose to package and compete the work performed at the ADCs as part of their Competitive Sourcing Program. This program focuses on reassessing agency functions to create a more efficient and effective organization through opening the work to competition between the (current) public sector and bidders from the private sector.

The public employee team proposed a major restructuring and won the competition against the private sector bidders—promising improved performance with 60 percent fewer employees, and closing two of the three facilities.

Forms of market-based government such as the competitive sourcing program at the IRS are changing the way government

provides services to the American public. These methods present government agencies with options to transform themselves into more efficient organizations that can obtain the best value possible for the American taxpayer. The competitive processes that these methods spark create the pressure necessary to achieve dramatic results, such as in the IRS case—no matter whether the winner of the competition is the public or private sector.

### BACKGROUND

The federal government has had a long-standing policy neither to produce products nor to provide services that are available in the private sector.<sup>1</sup> It has generally failed to uphold this policy. In fact, throughout the last century, government, at all levels, has assumed the responsibility for the provision of more and more services; now federal, state, and local government spending make up one-third of the national gross domestic product.

This expansion in the role of government, coupled with income tax cuts and the budgetary pressures of Social Security and Medicare, has resulted in large federal budget deficits. The Congressional Budget Office estimated that the budget deficit will exceed \$370 billion for the 2006 fiscal year, and will be in the vicinity of \$355 billion in 2007 (Reuters, 2006). David M. Walker, the Comptroller General, in his testimony on the state of the state of the federal budget, asserts that the fiscal deficit problem is so large that economic growth by itself will not be a sufficient solution (Walker, 2005). As a result, the federal government will face continued pressure to provide more and improved services, while maintaining or reducing costs. Market-based government, i.e., shifting from a monopoly to a competition-based environment for the provision of all but the “inherently governmental” functions, is one reasonable approach for improving the performance of government programs, while reducing their costs.

The move towards market-based government began in earnest in the 1980s. The early initiatives were with privatization and public-private competitions under the auspices of Office of Management and Budget (OMB) Circular A-76.

Many of the themes for privatization were formulated by Milton Friedman in the early 1960s in his book *Capitalism, Freedom and*

*Democracy*; key among those was his analogy between government and private monopolies. This concept legitimized the criticism of big government, and anchored this criticism in classic microeconomic theory. There wasn't much movement by the federal government to privatize, however, until the Reagan administration put privatization on the public agenda early in its first term. The Reagan Administration emphasized the view that big government was inefficient, wasteful, and unmanageable; and, early in Reagan's first term, the administration began to formulate aggressive proposals for the sale of a wide range of governmental assets. Proposals included the sale of federally owned park and wilderness lands, the Conrail and AMTRAK rail lines, as well as a major petroleum reserve. In Reagan's second term, his administration coined the still unfamiliar term "privatization" under the argument that privatization was an adoption of private means to achieve public goals. The President's Private Sector Survey on Cost Control, defined privatization as an option "allowing Government to provide services without producing them" (Henig, 1989-1990, p. 662 ).

The Clinton administration also recognized the need to reform the way government procures goods and provides services. President Clinton initiated the National Performance Review (NPR), which served as an impetus for procurement reform. The NPR effort broadened the goal of creating a government from one that "works better and costs less" to a government that works better, but is also smaller. The NPR promoted the idea that government should focus its attention on those activities which it should and could do best, and then put incentives in place to insure optimum results (Gore, 1993, p.1). These efforts resulted in a flurry of public-private competitions under the Office of Management and Budget Circular A-76, primarily within the Department of Defense.

When George W. Bush took office in 2001, he claimed "competitive sourcing"<sup>2</sup> as one of his top management initiatives. Bush stated that federal workers should compete with contractors for as many as 425,000 governmental jobs that were identified as commercial activities, i.e., a product or service that could be obtained from a commercial source (Bush, 2002).

However, all of these initiatives were received with apprehension and resisted by many groups. From its onset, privatization faced heavy resistance from labor unions and congress. And, despite the

growing evidence that competitive sourcing improves performance and decreases cost, it also continues to face strong opposition from federal employees, their unions, their political allies, and more recently, civil rights groups—all of whom are fearful of losing federal jobs. For example, in 2003, thirty five senators signed a letter to the Office of Management and Budget, responding to the Administration's competitive sourcing initiative by stating that they have "deep reservations about privatizing so much of the federal workforce" (Lee, 2003, p. A21). Public unions continue to spend considerable resources trying to convince the public and Congress that monopoly provision by government agencies is the most effective way to produce public services, and should therefore, be maintained. As a result of the strong opposition from unions and lawmakers, the competitive sourcing initiative has been successfully slowed. By 2005, of the initial Bush goal of 425,000, only 50,000 jobs had been studied (Lee, 2006).

Still other opponents of market-based government stipulate that competition rarely leads to savings and that the current monopoly-based environment should be maintained. They believe that the public sector can, for the most part, provide the same services as the private sector for about the same cost (Sclar, 2000), however little data to support this position is provided. In fact (as noted below) the data which does exist shows just the opposite i.e. better performance at significantly lower cost.

Despite administration attempts to address the concerns of opposition groups, the resistance has not subsided. When advocating these initiatives, administration efforts have often focused on reducing cost when presenting them to the public, while not addressing the more important effects of increased competition on improvement in the performance of the provision of services. Consequently the efforts were viewed as cost cutting measures, along with the expectation of reduced service quality, accompanied by layoffs of large numbers of government employees. To date these market-based government initiatives have not resonated with the public in general.

Along with privatization and competitive sourcing, outsourcing and public-private partnerships are two other available sourcing options that can be used to introduce competition. All are defined below.

**Competitive Sourcing** (a new term introduced by the Bush Administration for public-private competitions that are held in accordance with OMB circular A-76) has been employed by federal agencies for almost 40 years in an effort to improve the quality and flexibility of government services, and to save tax dollars. Competitive sourcing occurs when government and private sector providers compete to carry out commercial activities. In 1966, OMB issued Circular A-76, which includes guidelines for federal executive agencies to evaluate whether commercial activities should be performed by government sources, by private sector sources, by another federal agency through an Interservice Support Agreement (ISSA), or through public/private competition (Gansler, 2003).

**Outsourcing** differs from competitive sourcing in several ways. With outsourcing, the government agency concludes, in advance, that the best way to achieve greater efficiency, higher performance, and substantial cost savings is to contract out the work to a private vendor. There is no competition between the government agency and the private vendor for the work to be performed. The “competition” is among the private vendors bidding for the contract to perform the work or perform the service. Also, outsourcing is not the same as privatization. Through outsourcing, the workload is shifted from the in-house government providers to the private sector, but no sale or transfer of assets has occurred (Gansler, 2003).

**Privatization** is the transfer of assets or responsibility from the government to the private sector. In many cases privatization often includes a wide range of public-private partnerships, such as voucher systems, commercialization, and franchising. Some even consider the creation of federal corporations, quasi government organizations, commercialization, and government-sponsored enterprises as forms of privatization (Office of Management and Budget, 2004).

**Public-Private Partnership** is “an arrangement of roles and relationships in which two or more public and private entities coordinate/combine complementary resources to achieve their separate objectives through joint pursuit of one or more common objectives” (Lawther, 2002, p. 9).

### **The Federal Government's Need for Market-Based Sourcing**

What is being asked of the federal government is essentially what was demanded of US private industry in the latter part of the 20<sup>th</sup> century in order to remain competitive. The goal of federal policy should be to create a government that looks a lot more like a dynamic, restructured, re-engineered, world-class business. There are many good examples of successful American businesses (FEDEX, Caterpillar, Dell Computers, etc.) which have come to rely on core competencies to do what they do best. The federal government can learn from their successes to focus on public core competencies, such as policy, fiscal management, oversight, and warfighting. For all other activities, the public sector must rely more and more on competition to achieve higher performance at the lowest cost, and to get the “best value” from either the private or the public sector.

The overarching objective of market-based government is to introduce that competition, and wherever possible eliminate monopolies. In addition to providing fewer services at higher prices, monopolies typically discourage innovation and improvement. In 2001 the Bush administration estimated that there were approximately 850,000 jobs that were not inherently governmental, and were currently being done on a monopoly basis by government workers (Peckenpaugh, 2001). Rather than have work performed on a monopoly basis by government workers, market-based government would allow the private sector to also compete for these jobs. After all, cutting grass, hanging drywall, or turning a wrench in a maintenance facility are not inherently government jobs. However, after five years of implementation, only a small fraction of those positions have been competed—7,213 positions were competed in FY2005 (Office of Management and Budget, 2006).

Numerous studies clearly show that when such work is competitively awarded—regardless of whether the public or private sector wins the competition—job performance improves, with a significant cost savings (Gansler, 2003; Savas, 2000). In cases where it has been possible to quantify performance improvement, that improvement has averaged 109 percent (Gansler, 2003) with an average cost savings of over 30 percent, without a significant negative impact to federal employees (Gansler & Lucyshyn, 2004). The most recent reported competitive sourcing results project a net saving of \$3.1 billion for competitions completed in FY 2005 (Office

of Management and Budget, 2006). Market-based government is clearly one strategy that can be used to improve the government's effectiveness and efficiency.

### RESEARCH METHODOLOGY

The aim of this chapter is to gain insight from a series of case studies of examples of market-based government sourcing alternatives. The approach taken in conducting and analyzing the case studies was that recommended by Yin (Yin, 2002) and Eisenhardt (Eisenhardt, 1989). This approach allows a theory to emerge inductively as a result of analyzing a series of case studies.

The cases, summarized below, highlight how different organizations have implemented outsourcing, competitive sourcing, privatization, and public-private partnerships in an effort to achieve better performance and reduced costs. This analysis focuses on the challenges organizations faced, the results they achieved, and the lessons learned. Available data regarding pre-competition and post competition costs, as well as performance levels, was used to determine the gains of competition in all cases.

### CASES

#### **The IRS uses Competitive Sourcing (Lucyshyn & Young, 2004)**

The Internal Revenue Service (IRS) processes 13 million tax returns annually. Although in the mid 1990s the IRS had a large force of 100,000 employees, and an annual budget of \$10 billion, the agency was criticized for several deficiencies. Despite the information revolution, the IRS was still processing tax returns using concepts and systems developed in the 1950s, including batch processing and magnetic tape storage on reels. In the late 1990s, the IRS began to take such deficiencies seriously and concluded that the key to providing improved services was modernization. A main incentive to modernize was the 2001 President's Management Agenda that required all federal agencies to implement competitive sourcing.<sup>3</sup>

The IRS adapted competitive sourcing as a tool in its overall modernization efforts, but put in place a very deliberative process, conducting business case analyses and reassessing the overall functions of the organization. Deciding which units to compete under

OMB A-76 guidelines was difficult; since, as of summer 2004, approximately 33 percent of IRS functions were categorized as commercial in nature. The IRS finally decided to compete its Area Distribution Centers (responsible for written and telephone requests for documents) and its Campus Operations and Support; both competitions were won by the government employee unit, known as the Most Efficient Organization (MEO).

The IRS Media and Publications Division (MPD) was the third largest government publisher and one of the top 10 high-volume mailers in the government and commercial fields. The MPD delivers products using traditional paper printing as well as through other formats – including fax, CD-ROM and Internet. The division maintained three Area Distribution Centers (ADCs) in Bloomington, Illinois; Richmond, Virginia; and Rancho Cordova, California. The IRS chose to group and compete all the work performed at the ADCs in a single competition. This approach made it possible to solicit bids for all aspects of the ADC functions. The winning IRS employee team proposed closing both the Virginia and California facilities, and eliminate 82 seasonal employees at the remaining Illinois facility.

The competition of the IRS Campus Center Operations Support and Services sought a provider that could supply all services, materials, supplies, facilities, supervision, labor and equipment for support at all 10 IRS centers located throughout the US. The IRS chose to make a single award for all service centers. All bids were evaluated according to technical criteria, management criteria, and the past/present performance. Like the ADC competition, the public employee unit (MEO) won the bid. According to the MEO proposal, of the 278 technology-related positions that were competed across the 10 centers, 218 would be eliminated. This was possible because the MEO reengineered processes and redesigned the work.

Although the public sector won in both cases, the existing processes were changed dramatically, and the resultant reductions in personnel were significant – 60 percent and 78 percent respectively. Strategic leadership, planning, and the impact of competition made possible these dramatic results.

#### **NASA Outsources Desktop Services** (Lucyshyn & Maly, 2004)

The NASA Outsourcing Desktop Initiative program (ODIN) is a case study of a successful Information Technology (IT) outsourcing

program. In 1996, NASA approved the ODIN concept, which it defined as a “long-term outsourcing arrangement with the commercial sector which transfers to it the responsibility and risk for providing and managing the vast majority of NASA's desktop, server, and intra-Center communication assets and services as the Agency downsizes and refocuses IT personnel to Agency core missions” (Lucyshyn & Maly, 2004, p. 15) Through ODIN, NASA officials hoped to cut desktop computing costs, significantly increase service quality, achieve interoperability and standardization among NASA computer operations, and allow NASA employees to focus on their core responsibilities.

After soliciting and reviewing nine proposals, the ODIN program awarded indefinite-delivery, indefinite-quantity (IDIQ) contracts to a pool of seven contractors. Each NASA service center would then choose a contractor from the pool and use that vendor as its exclusive desktop service provider for a period of three years. The contractors in the pool are not guaranteed sales—they must compete with each other for NASA's business.

One concern expressed by both government employees and managers prior to ODIN's launch was the possibility of involuntary displacement of employees. However, one of the objectives of the ODIN program was to shift government IT personnel from administrative support to core missions, so in practice, ODIN caused zero involuntary personnel displacements. Overall, the ODIN program minimized the negative impact on employees, while refocusing government personnel on core research and development activities.

Since the ODIN program was introduced, NASA research centers have seen significant changes. Although the previous support met the minimum required service levels, the age of the equipment varied widely, with some organizations using computers that were up to ten years old. This variety of equipment created issues and challenges with standardization, interoperability, and security. Since, the computers and IT support were sourced from several organizational levels; there was no adequate way to allocate all costs. Under the ODIN contract the age of the equipment across the agency is much more consistent, with a range up to three years, and an average age of 18 months. Because hardware and software are standardized across each center, interoperability and security are significantly

improved. The service provided by the ODIN contracts now generally exceeds required service levels, as well as a firm-fixed price per seat.

**Auxiliary Power Unit Logistics Support Program** (Lucyshyn, Rendon, & Novello, 2005)

In April 1998, the Navy chose to begin its first public-private venture. The program manager for the F/A-18 fighter Auxiliary Power Unit<sup>4</sup> (APU) at the Naval Aviation Depot, Cherry Point (NADEP-CP) was tasked with developing and implementing a partnership between NADEP-CP and private industry to help reduce the cost of managing and distributing repairable F/A -18 auxiliary power units and to increase system reliability, maintainability, and related spare parts availability. Naval aviation depots are responsible for the repair, rebuilding and overhauling of aircraft weapons systems.

NADEP-CP was constantly challenged with providing a steady stream of overhauled APUs to the fleet commanders due to an increasing inventory of aging APU components, poor spare parts support, and rapidly decreasing mean flight hours between unscheduled APU removals.

Moreover, in the late 1990s, the Depot was facing an increasing backlog of APUs in need of repair. The APU availability had decreased to approximately 65 percent, the customer wait-time was as high as 35 days, and repaired units were delivered on-time only 20 percent of the time. At the same time maintenance costs were increasing significantly. The need for a new approach was evident. The program manager believed that a public-private partnership would serve the dual purpose of improving support for the F/A-18 program and also maintaining the Navy's organic maintenance capability.

The envisioned partnership would have the private contractor responsible for overall program execution, along with the procurement and management of all consumable parts used by NADEP-CP to repair APUs. NADEP-CP would focus on its core competency of the repair and overhaul of the APUs. Such a partnership would involve a direct vendor delivery (DVD)/total logistics support (TLS) arrangement; in this case, responsibility for reliability and maintainability would be shifted to the private sector. The approved business case analysis of the arrangement concluded that the Navy would save \$13.8 million over ten years by awarding the DVD/TLS contract to Honeywell. The Naval Inventory Control Point

(NAVICP) later identified other quantitative benefits of the contract totaling \$34.8 million.

There was a natural resistance to the plan based on a fear of public sector job loss. The management team worked hard on their communications reassuring depot employees and union representatives that the partnership would not significantly affect the employee status quo, as well as gathering Congressional support.

In June 2000, NADEP-CP signed a ten year (five base years with five one-year renewal options) Firm Fixed Price, performance-based contract with Honeywell (Caterpillar Logistics as a major subcontractor). The contract is priced by the flight hour, under which the contractor does not price each repair part individually, but develops prices based on total contract cost; as a result the Navy now knows the cost of maintaining the APUs and can budget accordingly.

Under this contract, Honeywell, as the prime contractor, procures and manages all consumable items used by the depot to repair the APUs and subcontracts the repair effort back to the depot on a cost-reimbursable basis. Honeywell subcontracts data management, inventory management and parts delivery to Caterpillar Logistics.

This partnership between NADEP-CP and Honeywell proved to be very successful. Performance data between July 2000 and October 2002 showed great improvement on APU maintenance and availability. The availability improved from 70 percent to 90 percent. The number of APUs awaiting depot repair because of lack of parts decreased from 118 to zero. Back orders were reduced from 125 to 26 and average delivery time went from 35 days to 5.4 days. Overall, 98 percent of requisitions were filled within the contractual requirements. In 2004, NAVAIR provided further signs of success. APU back orders for five additional aircraft models decreased to zero and supply availability increased to 97 percent (Heron, *Personal Interview*, 2006, April 21).

**Public Private-Partnerships to Supply C-130 Parts** (Lucyshyn & Roberts, 2004)

The Defense Logistics Agency (DLA) is a Department of Defense (DoD) combat support agency that provides material support to the military services. In an effort to improve the integration of its supply chain, DLA expanded the prime vendor concept, calling it the next

generation “Virtual Prime Vendor” (VPV). In the VPV model, the vendor generally manufactures some products, and purchases and stores other manufacturers’ products as needed. In 1996 DLA chose to implement the VPV concept to provide parts and consumables for the maintenance of C-130<sup>5</sup> aircraft propeller assemblies at the Warner Robins Air Logistics Center (WR-ALC) at Robins Air Force Base, Georgia. DLA hoped that by building an integrated PV-run supply chain, the parts for the C-130 would be shipped faster and cheaper, while the DLA itself would manage the Prime Vendor contract rather than the actual inventory.

Prior to DLA’s virtual prime vendor initiative, the Department of Defense’s efforts to expand the use of prime vendor contracts had been primarily restricted to commercial supplies, such as food and medical supplies. DLA’s contract with Hamilton Standard to supply components for the C-130 military cargo plane, under a virtual prime vendor contract, was the first major attempt to apply the concept to a key component of a major weapons system.

In 1996, the Defense Supply Center Richmond (DSCR), DLA’s lead center for aviation support, requested proposals for establishing government-industry VPV relationships in support of weapons systems maintenance. The team received 14 abstracts; seven of the contractors were asked to follow up with specific submissions. Ultimately, the team found that the Hamilton Standard C-130 engine proposal was a perfect candidate for a prototype VPV effort. Not only did Hamilton Standard already produce approximately half of the consumable parts (by value) for the C-130 propeller assembly, but it also had significant ties with the contractors who provided the other parts.

On October 10, 1996, under the auspices of the VPV program, the contract was awarded to Hamilton Standard—an initial one-year indefinite-quantity contract for DLA consumables, with four one-year options; the estimated yearly value of the contract was \$22 million.

This contract was based on specific metrics that were chosen to incentivize performance, rather than the quantity of parts sold. The metrics were based on system availability, customer service, and order-to-receipt time, rather than number of orders placed, number of repairs etc. In fact, the acquisition plan specified that the VPV’s management should have a significant impact on key metrics while also developing “reliable/consistent delivery on a required delivery

date, expedite[d] processing services, and surge capability” (Lucyshyn & Roberts, 2004, p. 69). The VPV was required to submit these metrics for review and evaluation. After the first C-130 Propeller Assembly VPV Contract expired in June of 2002, DLA revised these metrics for the follow-on contract with Hamilton Sundstrand.<sup>6</sup>

Since it re-awarded the VPV contract to Hamilton Sundstrand, DLA has continued to reduce its remaining inventories. Beginning in September 1994 with an inventory valued at \$12 million, the inventory was reduced to \$222,000 in 1996—a reduction of 98 percent.

DLA then re-evaluated and modified the metrics that it uses to monitor the contractor’s performance. The metrics used in the new contract are Contractor Performance Time (CPT) and Time on Backorder (TOB).<sup>7</sup> Additionally, the current contract has added a Contract Incentive Plan, which provides a method to motivate the vendor to exceed performance requirements- the vendor can earn additional service fees for exceeding CPT and TOB performance requirements, but earns negative points when failing to meet the minimum requirements. As of September 2004, the vendor has surpassed all contract performance requirements. For example, DLA required the contractor to ship 90 percent of delivery orders within 8 days, but in September of 2004, Hamilton Sundstrand was shipping 99.4 percent of all orders within the required time (Brown, 2004).

While integrating government supply chains is difficult for large and complex networks, this case demonstrates that the virtual prime vendor model can work, even for large, complex military weapons systems.

### **The US Navy Uses Privatization-in-Place for the Naval Ordnance Station, Louisville** (Lucyshyn & Novello, 2005)

Privatization-in-place has been attempted at only a handful of military facilities around the country, and the Louisville Depot was the first to complete the process.

By the 1990s, the Naval Ordnance Station, Louisville (NOSL) was the only Navy facility able to provide both major overhaul and complete engineering and technical support services for the Navy’s surface weapons systems. Despite NOSL’s unique capabilities, in the post-Cold War years, the facility suffered from excess capacity. By

1993, the Louisville depot had a maximum potential capacity for 3.8 million direct labor hours, but was only performing 1.3 million hours of work, only 34 percent utilization. The depot was put on the Base Realignment and Closure (BRAC) list for the 1993 round but escaped closure. The Mayor of Louisville had anticipated that the depot closure would result in the loss of 1,200-1,400 jobs and a reduction in local payroll of more than \$25 million. When the depot was put on the BRAC list again for the 1995 round, city officials decided to recommend the privatization of the whole depot operation and began to work with United Defense (a defense contractor that produced some of the major systems maintained at the depot) on a detailed plan.

Over a period of four months, a United Defense team worked intensely with individuals at NOSL to gain a better understanding of the NOSL enterprise, with its 40 product lines. Two of the products constituted 60 percent of the work. However, one of those two main product lines, the Phalanx Close-In Weapon System, was outside of United Defense's production portfolio. Key NOSL personnel recommended that they also bring in Hughes Missile System Company (now Raytheon), the Original Equipment Manufacturer (OEM) for Phalanx into the arrangement. With Hughes in the picture, the United Defense team continued to work with the Louisville stakeholders to collaboratively create a plan to privatize the NOSL business in place.

The city of Louisville successfully lobbied the plan and in June 1995, the BRAC commission recommended privatization of the NOSL facility and workload. In August of 1995, President Clinton accepted the recommendation. The Navy estimated that transferring the work to other naval facilities would cost approximately \$302 million, while the privatization-in-place would cost \$170 million less.

Although Louisville had worked closely on a privatization plan with United Defense, it decided that it was going to compete the business among multiple companies. The idea was that with competition would come concessions and a more favorable contract for the city and residents of Louisville. United Defense won the contract. The final agreement between Louisville and United Defense consisted of a series of different types of contracts over designated time periods. The performance contract covered a six week based period (August

19 - September 30, 1996), plus five one-year option contracts corresponding to governmental fiscal years 1997 through 2001.

In preparation for a “hot turnover” United Defense took steps to address concerns about displaced employees. As a result, all employees were offered jobs with benefits similar to those they had with NOSL. Of the 234 offers made, 189 people accepted.

Ultimately, the privatization of NOSL was a win-win-win situation for the Navy, the city, and the two private defense contractors involved. The Navy eliminated the overhead costs of operating the depot while retaining key naval gun manufacturing skills. In addition, the quality of work in the gun facility improved dramatically—the number of defects per 1000 hrs of direct labor was reduced by 77 percent, productivity per employee was increased by a factor of 5, and delivery performance was 99 percent. The city of Louisville saved jobs that it would have completely lost with the closure of the depot. It is estimated that in 2004 the payroll at depot was around \$30 million. Finally, United Defense significantly increased plant productivity, while simultaneously streamlining the workforce; and Raytheon also increased productivity, as well as experiencing a rise in demand for the Phalanx product and growth in the number and types of products assembled.

## RESULTS

Overall, these five cases show that when a market-based government strategy was implemented there was a significant improvement in performance with a corresponding reduction in costs (see Table 1). The IRS competitions exemplify the extraordinary outcomes that can be achieved through competitive sourcing when agency leadership is committed to investing time and effort in serious planning for competitions and when business case analyses are used in the planning process.

With the implementation of the ODIN program NASA met its overall objectives and benefited from other positive results. The primary objective of increasing employee focus on core tasks and increasing security were met, but perhaps more importantly, NASA saw improvements in service delivery and service consistency. With the ODIN model, NASA managers have visibility of the true IT support cost, and, as a result, NASA was able to lower per seat costs. By

having several qualified contractors, NASA was able to maintain a competitive environment and sustain these savings over time.

The Defense Logistics Agency's contract with Hamilton Standard to supply components for the C-130 military cargo plane was the first

**TABLE 1**  
**Summary of Case Results**

Type	Case	Performance	Cost
Competitive Sourcing	IRS ADC Competition	Reduced operations from 3 to 1 site, reengineered processes, and enhanced the use of technology.	60% reduction of workforce
Competitive Sourcing	IRS Campus Ops	Reengineered processes, significantly reduced FTEs, and enhanced the use of technology.	78% reduction of workforce
Outsourcing	NASA ODIN	<ul style="list-style-type: none"> <li>• Exceeded required service levels.</li> <li>• Hardware/software were standardized at each center.</li> <li>• Interoperability and security were much improved.</li> </ul>	From no adequate way to allocate IT costs to firm fixed price
Public/Private Partnership	C-130 Parts	Surpassed all required performance metrics.	Inventory reduced from \$12M to \$222,000.
Public/Private Partnership	APU Support Program	<ul style="list-style-type: none"> <li>• Availability improved—70% to 90%.</li> <li>• # of APUs awaiting depot repair from 118 to zero.</li> <li>• Avg. delivery time from 35 to 5.4 days.</li> <li>• 98 % of requisitions filled within contract limits.</li> </ul>	Savings of \$13.8 million over ten years plus other quantitative benefits totaling \$34.8 million
Privatization-in-Place	NOSL	Improvements in productivity, product quality, availability, reliability, and maintainability	Privatization saved \$170 million

attempt to apply the VPV concept to a key component of a major weapon system. It is clear that the reduction in costs was not done at the expense of quality. The study shows that when requirements are adequately defined, quality does not have to be sacrificed. In the public-private-partnership arrangement to supply C-130 parts the DLA reduced its overall costs with a 98 percent reduction in inventory. The vendor, Hamilton Sundstrand, managed to achieve this cost reduction, while still surpassing all contractual performance metrics. Using performance-based metrics helped to align the contractor's profit motive with the government agency's performance objective. Instead of performing the activity, the agency is now able to procure a result, and better able to focus on its core competencies.

The Navy's Auxiliary Power Unit contract incentivized the contractor to reduce the numbers of failures; and that meant reliability improvements had to be made to the APUs themselves, the technical publications, and the training, all at the contractor's expense. This program leveraged the private sector's ability to procure piece-parts and rapid delivery with investment funds for high-payoff modifications, with the Navy's ability to provide craftsman and skilled labor. The result is a high-quality product, with reduced critical maintenance manpower requirements and operational costs.

Finally, in the case of the Naval Ordnance Station in Louisville, the privatization allowed the Navy to eliminate the overhead costs of operating the depot, improved the quality and efficiency of the support, while allowing the private sector to rationalize the excess depot capacity.

Based on the analysis of these cases the following are the key lessons learned:

*Market based government initiatives require strong leadership.* These cases demonstrate that implementing an effective market-based government program requires a major cultural change within the affected organizations, as well as changing the beliefs of many of the stakeholders. Achieving this transformation required committed senior leadership. This leadership was required to develop the strategy, conduct the planning, and then follow through with the execution. Leaders were continuously focused on creating the best value for the government—not just looking for the lowest cost solution.

*Thorough planning is essential.* Good planning was another critical element in these successful market-based government experiences. The leadership in these cases all approached their challenge from a strategic enterprise perspective, and viewed this as an opportunity to restructure and reengineer their organizations. Once a process or function was identified, a detailed business case analysis was done to determine if it would be beneficial to move ahead with the initiative. This process proved valuable, independent of the results, since it provided a better understanding of the organization—what they did, why they did it, and how much it cost. Finally, the planning always considered the impact on the employees, and made every effort to minimize that impact.

*Improve cost accounting to inform market-based government initiatives.* The capability to identify the true cost of an activity is critical to discovering opportunities for cost improvement, to prepare a business case analysis, and improve strategic decision making. Traditional government cost accounting systems often mask the true costs associated with producing items or performing services making it difficult, if not impossible to compare various sourcing options. Organizations should work toward developing financial systems with a capability to identify the true costs (direct and indirect) of performing commercial activities.

*Get the facts and make them widely available.* Improving communication both within government agencies themselves and with external stakeholders greatly reduced resistance and improved the environment in which these sourcing decisions were made. For example, in many instances opposition to market-based government initiatives was founded in fears that the changes would result in poorer performance, higher costs, and significant job losses for government employees. These fears are generally unfounded; as these cases show, performance improves, costs are reduced, and the rate of involuntary job loss is low.

Communicating such findings is key to creating a friendlier environment and reducing the resistance to change. Additionally, carefully framing and clearly communicating the intentions and plans of agencies considering any form of market-based sourcing

can go a long way toward allaying the fear of market-based sourcing among government workers, unions, and the public.

*Maintain a competitive environment.* The benefits of market-based government are achieved only if there is an open and fair competitive environment. Competitive sourcing, in particular, depends on the competitive pressure of the private sector to shape the government's Most Efficient Organization (MEO) proposal.

### CONCLUSION

Market-based government is one of many tools the federal governments can use to achieve greater effectiveness and efficiencies. The ultimate goal is not to shift work to the private sector, but to introduce competition with these sourcing strategies, then push for innovation that will result in that improved government performance and efficiency. As demonstrated in this study, four different approaches all resulted in improved performance and reduced costs. With proper planning the impact to government employees was kept to a minimum.

This approach can also be effectively used to transition these decisions from an ideological framework to a more pragmatic approach—allowing the most effective provider, from either the public or private sector, to provide the required service. With continued use, acceptance should follow. These initiatives improve the overall effectiveness and efficiency with which the government functions and through which it provides its citizens services—a welcome change for everyone.

### ACKNOWLEDGMENT

The author is deeply indebted to Carmen Zapata, a graduate student at the University of Maryland's School of Public Policy, who assisted in the research and editing of this chapter. The author would also like to thank Mark Abramson, IBM Center for the Business of Government, and RADM James B. Greene, USN (Ret), Acquisition Chair at the Graduate School of Business and Public Policy, Naval Postgraduate School, for their support of the detailed case research.

### NOTES

1. The executive branch first addressed the performance of commercial activities by government agencies in 1955—see Bureau of the Budget's *Bulletin 55-4, Commercial-Industrial Activities of the Government Providing Products or Services for Governmental Use* (January 15, 1955). The current policy that addresses the performance of commercial activities is contained in OMB Circular A-76. The circular was originally issued in 1966, and has been revised several times. The most recent revision was released in May 2003.
2. A term first used by Bush to describe the competition of commercial activities performed by the government between the public and private sectors.
3. Competitive sourcing involves agencies opening their commercial activities to competition from both public and private sector sources, and the rules of competition are set forth in the Office of Management and Budget's (OMB) newly-revised Circular A-76. A commercial activity is one which is operated by a Federal executive agency, and which provides a product or service that could be obtained from a commercial source.
4. An APU is a self-contained generator used in aircraft to start the engines and provide electrical power while the aircraft is on the ground.
5. The C-130 is a four-engine turboprop cargo aircraft used for airlift of equipment, people, and supplies.
6. Hamilton Sundstrand was formed by the merger of United Technologies' Hamilton Standard Division with the Sundstrand Corporation in 1999.
7. CPT is defined as the number of days from the date the delivery order is issued to the date that the total quantity order is shipped, and it applies to each delivery order individually. TOB is defined as the vendor's average time for delivery of back-ordered items as well as the average time for all back-ordered delivery orders still pending at the end of the performance period.

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