

Insourcing: the Unsettling State of Play

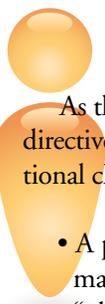
By Stan Soloway, President and CEO, Professional Services Council

What happens when you mix a political directive, a strategic human capital initiative, and a budget drill? A multi-faceted mess.



When Defense Secretary Robert Gates announced his intention to rebuild critical skills at the Defense Department in April 2009, the reaction—including from industry—was highly supportive. Few disagree that the department needs to enhance its internal capabilities. Specifically, Gates called for the addition of 35,000 to 40,000 civilian personnel to the department's ranks, the majority of which would be in the acquisition field. Of that total number, about half will be insourced from currently contracted work, with the remainder coming through new hires. In the end, Gates will reduce contractor personnel from the current level of 39 percent of total manpower to the pre-2001 level of 26 percent. Contrary to the assumptions some have made, that percentage reduction reflects reductions in contractors performing identified, critical work (i.e., acquisition, program management, etc.). Simple math makes clear that the reduction is not about the total role of contractors at DoD. Moreover, the guidance attached to the secretary's directive makes it clear that the target activities are inherently governmental functions, acquisition support (about two thirds of the total), non-inherently governmental work that must be performed internally in order to ensure DoD has adequate control over its operations and missions, unauthorized personal services, and a small portion of other, undefined, activities for which government performance would be less expensive than contractor performance.

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As the department implements this directive it is also faced with two additional challenges:

- A politically driven legislative mandate to develop an insourcing “plan” under which “consideration” is to be given to insourcing a wide range of activities that had been outsourced.
- Growing budgetary pressures.

As a result, DoD components are engaged in a sweeping effort to reassess what has been contracted and what can or should be brought in-house to meet these mandates.

Unfortunately, the mandates grow from different roots and do not lend themselves to a consistent, department-wide strategy. The result of this amalgam of disconnected activity will deliver neither the savings nor the workforce enhancements DoD seeks.

The Quota Dilemma

As part of the budgetary implementation of the secretary’s initiative, each of the military services and major DoD agencies was given a specific savings target, despite congressional admonition to avoid such quotas. For example, according to Air Force Materiel Command documents, AFMC’s “share” was approximately \$500 million in contracts to be replaced by approximately 3,000 new civilian personnel billets. Moreover,

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Insourcing Case Study: Whither the savings?

As the Defense Department implements Gates’ directive and implements the legislative mandate to “consider” insourcing a wide range of activities, serious questions are emerging as to whether the savings presumed in current and outyear DoD budgets are real and achievable.

A case in point is the Air Force’s decision to insource several thousand positions performing pilot training at six of the seven Air Force bases where the training is currently performed. This work has been outsourced for decades and no one argues that the work is so vital that it must be performed by government civilians. The contractors’ flight instructors are experienced, former pilots who actually flew the equipment for which the training is being conducted.

Despite the history and experience with outsourcing this work, approval has apparently been granted for insourcing the vast majority of it. But, to what end? Certainly not because savings will be achieved. Internal Air Force documents obtained through a Freedom of Information Act request show the total “savings” resulting from the insourcing will be under \$500,000 against a total contract spend of well over \$220 million. That is less than one-fifth of one percent.

Moreover, the Air Force documents show that the total civilian manpower assigned to this work in the future will be measurably less than that which is today provided by contract. Given the small margin of savings, it is logical to extrapolate that, on a per person basis, government performance of this work is significantly more expensive than performance under contract, even though in a few cases the government wages offered will be less than that which the current contractor employees now receive. Wages aside, for the vacation and other benefits accrued by virtue of their seniority, all of the trainers who do get hired by the government will lose their accrued leave and be required to start from square one.

Further, the cost comparison the Air Force conducted was inconsistent. The comparison included contract elements that have not been exercised, and therefore do not belong in the analysis (and which themselves exceed the total “savings” identified by the Air Force). Nor does it appear that the cost assumptions for internal performance include the true, total costs associated with doing so. Indeed, although the documents do not fully disclose the costs that were included in determining the in-house performance cost, other Air Force documents provide interesting insights into how that critical question is being addressed.

In January, the Air Force Materiel Command (AFMC) issued internal guidance on insourcing. In addition to explicitly acknowledging the existence of both dollar (\$560 million in contracts) and positional quotas (3300 new end strength civilian positions), the guidance makes clear the limited nature of the cost analysis process. Perhaps the best evidence of this is in the “Frequently Asked Questions” portion of the Air Force guidance:

Question: *Was there a non-pay tail added in for each new civilian authorization to account for supply, training, travel, and other costs?*

Answer: *No. The intent of the conversions was only to remove the contract labor costs.*

That remarkable statement confirms what many have been concerned about: the cost analyses do not even attempt to capture the total cost to the taxpayer of these conversions.

Although the AFMC document refers repeatedly to “Advisory and Assistance Services” (thus tying the guidance to the kind of work identified in the Gates’ directive), there does not appear to be any additional guidance for the insourcing of non-essential work. In the case of the pilot training contract, routine training in areas such as ethics

presumed savings from insourcing have been, and continue to be, included in the component or service budgets. In other words, the quotas have both numeric (positions) and dollar value metrics attached to them.

And herein lies the foundation for the situation today—the majority of the insourcing we see is, in fact, tied to budget reduction goals and NOT to Gates' overarching workforce enhancement goals.

That is not to say that no progress is being made in building critical skills. According to DoD, as of March 1, approximately 5,000 positions were identified for insourcing that are either inherently governmental or so critical that they must be performed by government employees that the cost of insourcing or hiring these skills is not a predominant concern.

However, DoD has identified an additional 12,000 positions for insourcing that are not of a critical

nature and for which a cost savings must be identified. Yet, as of today, no process exists within DoD, or elsewhere in government, to accurately and fully account for the total costs involved. Moreover, although each of the military services are conducting some type of cost analyses, the evidence suggests that the analyses are limited to comparing the direct personnel costs of government with the total contract costs of companies.

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and information protection costs of approximately \$18,500 per individual for the contract period and is included in the contract cost. But the government cost estimate does not include training costs. Other than a standard, one-time, conversion cost, no consideration is given to the substantially higher-level of professional training and development that will need to be provided for positions that become vacant in the event individuals do not opt to accept positions offered by the government (which, according to the union representing the trainers, could be a significant percentage). Historically, "experience loss" has always been a factor in government outsourcing calculations. For example, it is required in depot maintenance cost comparisons between the public and private sectors. In the Air Force case, where the experience rests in the private sector and it is far from certain that a majority—let alone all—of the contractor employees will join the government ranks, full cost should be a significant factor in the insourcing decision.

Even more remarkable is that the current and outyear DoD budgets assume a 40 percent savings for every position insourced. Thus, even though the Air Force's data shows no savings, and hints at a likely increase in costs, the 40 percent is still built into the budget. This assumption is contained in the DoD Comptroller's Resource Management Directive (RDM) 802, which sets the budgetary realignment tied to the secretary's workforce initiative. It substitutes total contract spend, which includes all costs associated with the performance of the work, for personnel dollars on the civilian side. As AFMC states in its guidance:

"For every contract dollar decreased, 60% was returned for civilian pay for the conversions and 40% was retained by [the Office of the Secretary of Defense]."

The original intent of the RMD was to tie a budget statement to the specific support services skills targeted in Gates' workforce initiative. And in that arena—where much

of the work involves a form of on-site, staff augmentation for skills the government has not been able to adequately access—some (but certainly not all) non-pay costs will be more common than in the case of contracts where there is a total contract with a deliverable, such as those for pilot training, base operating support, logistics or IT services. However, that critical distinction is not being drawn and is instead being widely and inappropriately applied.

Moreover, even for the positions and skills targeted by Gates, the 40 percent savings assumption is wildly optimistic. As the AFMC guidance makes clear, the assumptions intentionally do not include a wide range of cost elements associated with internal performance. Missing are not only training, supplies, equipment and travel costs, but also lifetime healthcare and retirement costs, and the cost of administering both, which falls within the purview of the Office of Personnel Management once an individual retires. AFMC defends this by asserting that these costs are common to both contractors and the government, but it does not address the inconsistency presented when such costs are included in the total contractor performance cost and not in the government's internal cost assessments.

Further, in its guidance, AFMC acknowledges that despite the 40 percent savings figure, "AFMC's historic savings in previous cycles was less than 20 percent." As many people familiar with the competitive sourcing (A-76) program know, that 20 percent savings figure is what resulted from holding a competition, regardless of who won. Moreover, among the few longitudinal studies done on competitive sourcing, the most significant one was conducted by the Center for Naval Analyses and concluded that, for work outsourced as a result of an A-76 competition, the savings were well over 30 percent and were retained over time.

The DTM: Getting to the heart of it?

In late January 2010, the department released a Directive Type Memorandum (DTM) designed to identify a range of costs and cost assumptions to be used in making a cost comparison between contractor and in-house performance. However, the DTM comes months after the department had already determined that insourcing would save DoD 40 percent per position and thus is not yet a factor in the ongoing insourcing execution.

The DTM is a step in the right direction, but it still fails to provide a clear process and path forward for DoD components to obtain the requisite information. It also fails to include a host of costs directly attendant to government performance, such as this partial list:

- Automatic grade/wage increases for government employees; ironically, the DTM does require consideration of the escalation in contractor

labor rates included on their GSA Schedule contracts;

- Education assistance programs available to government employees;
- The costs of floor/rental space, which is included in contracts;
- The cost of goods, services and benefits identified in the DTM but for which no sources are provided;
- The government's sick leave, vacation and holiday costs, although such costs are required to be built into contract costs; and
- Overtime for non-exempt employees covered by the Service Contract Act.

Where does competition fit in?

The most distressing aspect of the current insourcing process is the lack of competition, even as the president and others declare that competition is the key

to enhanced performance and efficiency. Some suggest this is because the goal is, in part, to balance the mix of contractors and government civilians performing the work. But that is only relevant for the skills and capabilities the secretary identified as being most needed in the department. For the other two-thirds of positions already identified for insourcing, the guidance is clear that cost is the principal driver for insourcing. Here competition should play a central role, but it isn't being used.

Take the pilot training case study discussed on page 12, where even the Air Force's analysis, which does not include all internal costs, shows savings are essentially non-existent. The USAF analysis includes an assumption that fewer people can perform the work. What would be the real savings effect if the Air Force went to the marketplace and declared its need to reduce manpower and cost while still delivering the needed out-

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comes? Why is it assumed that personnel reductions can only be achieved through shifting from contractor performance to in-house government performance? Why is no consideration given to the potential innovation and efficiencies that competition drives? Moreover, what assumptions are included to account for the likely variations over time in workforce requirements? Contracted work lends itself to responding to such fluctuations; internal performance does not.

The Road Ahead

The Air Force training contract experience is not unique. At least two general officers and a senior executive, each from different military branches and each with intimate insight into the current insourcing trend, have privately acknowledged that arbitrary insourcing of non-critical

functions to meet a budget quota is now *de rigueur*. But there are signs of resistance to this quota-driven mentality emerging in the department and Congress. At least one announced insourcing of several hundred base operating support positions has been reversed by the Air Force. Some Defense leaders are beginning to question the accuracy of the savings data already being built into the out-year budgets. Moreover, members of Congress from both parties, many of them strong supporters of the secretary's initiative, are becoming concerned that the field-level implementation lacks discipline and analytical rigor.

To date, many of us have only been able to raise questions about what we are seeing. Now, with the emergence of more documents relating to more case studies, we are getting a fuller picture of what

is transpiring on the ground. Further, important work is also being done to help create a taxonomy that will, in the end, help lead to a more accurate portrayal of relative costs. But for reason and discipline to take hold, both sustained leadership attention and critical analysis are required. It's a task on which industry must join with Congress and the administration to play a significant role.

Some insourcing is justified by dint of the department's skills requirements. And in some cases, internal performance can be achieved for a lower cost and equal quality as the contractor. But until the questions generated by the facts as they exist today are answered, the truth about those instances will remain elusive. And so, too, will be the question of whether these insourcing actions will achieve the dramatic savings and workforce impacts that DoD seeks.

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