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TESTIMONY OF

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(LOGISTICS & MATERIEL READINESS)

BEFORE

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT,

THE FEDERAL WORKFORCE AND THE DISTRICT OF COLUMBIA

OF THE

SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL

AFFAIRS

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Overview of the Department of Defense

Business Transformation

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Chairman Voinovich, Senator Akaka and Members of the Committee:

Thank you for the opportunity to appear before you and discuss Business Transformation at the Department of Defense. Since this is my first appearance before the Senate, I would like to briefly describe to you my background and how it is relevant to DoD business transformation. I have been working on business transformation full-time since arriving at the Department of Defense two years ago. I am currently serving as Acting Deputy Under Secretary of Defense for Logistics and Materiel Readiness. In this role, I am acting as the senior DoD logistics official. Logistics, by the way, is probably the largest business operation at the Pentagon. I am engaged daily in transforming our Nation's $129 billion DoD logistics and supply chain enterprise. I am an engineer by training, earned an MBA from Harvard, and was a Partner at McKinsey & Company where I served leading commercial enterprises around the globe on matters of strategy, organization, finance, and business operations. I have started and sold a business. I was President of a large private corporation. I have worked in the commercial sector from start ups to the world's largest corporations. Chairman Voinovich, you mentioned in the last hearing on this subject the need for talent from the private sector to come into the government to help accelerate transformation. I hope my

background has some of the qualities you had in mind.

I would also like to emphasize how honored I am to appear be before you today. I am so grateful for the privilege of being able to serve our great country and in particular, I am humbled to have to opportunity to serve our men and women in uniform who daily risk their lives in the defense of America. I am also grateful for the work of this Committee and its commitment and dedication to improve the effectiveness and efficiency of government. I also thank you Mr. Chairman and Senator Akaka for the support you have provided us at DoD.

The Challenge

I would like to frame the challenge of business transformation within DoD. What has been most surprising to me in coming from the commercial world to DoD is the dramatic differences in scale and complexity. DoD has the world's largest fleet of aircraft, but is not an airline. We have the largest fleet of ships, but are not a shipping company. We have one of the largest fleets of trucks, and we are not a trucking company. We have the largest fleet of ground vehicles, but are not a rental car company. We are the second largest operator of warehouse space, but logistics is a supporting mission. In the private world, any one of our programs, armories, depots, shipyards, transportation modes, or logistics systems would be of sufficient scale to compete in the global market. I worked for Exxon early in my career, arguably the largest scale player at that time in the commercial sector. In comparison to DoD, it doesn't come close.

As far as complexity is concerned, there is no rival excepting the Federal Government as a whole. We are engaged in multiple fundamental business operations.

We are the world's primary researcher, designer, and developer of military hardware and software. While we depend heavily on private industry to assist us, the DoD has research, program management, product development, and procurement responsibility that spans more different types of product categories than any commercial firm that I know. From ships, to planes, to communications networks, to ground vehicles, to satellites, our product development scope is unprecedented. Furthermore, we don't stop at development. We take these products and utilize them around the world to provide services and capabilities to our warfighters. The comparison would be that we have the R&D and manufacturing responsibility of a Boeing in addition to the service operations of Delta Airlines and FedEx. While major integrated companies of the 19th century used to have similar capabilities (Ford for example used to make its own steel), our weapons system development efforts remain as the most vertically integrated business operation around. Typically, the market would disintermediate the value chain by creating players that specialize in one aspect thereof. Because of the limited number of customers for weapons systems and similarly limited set of suppliers, vertical market failure occurs requiring the DoD to maintain significant capabilities. Further, we don't want our enemies to have the best weapons. We have a preference for keeping them in the hands of our closest allies and our own forces. While we make every effort to utilize the commercial sector and find competitive sources of supply, we end up with a fairly limited set of suppliers for these complex products.

Our supply chains are equally complex. We have at least three major categories of supply chain. The first, most complex, and most expensive is our weapons system

support supply chain. Once the weapons systems are developed and fielded, the support, supply, and maintenance of these awesome tools requires enormous investments and infrastructure. Our depots, shipyards, intermediate maintenance facilities, supply and purchasing systems, and parts inventory are utilized by our team of dedicated military and civilian artisans to keep these systems available for our warfighters. The next major supply chain category is commercial commodities. DoD is the largest consumer of petroleum products in the world. We buy massive quantities of food, textiles, pharmaceuticals, construction materials, etc. The final category of supply chain is that involved in supporting deployed ground forces in austere international locations. This category connects the weapons systems and commercial commodities to the warfighter. In this environment, many of the quintessential business functions of the supply chain become truly military operations. No commercial company in my experience has ever had to face the supply chain complexity of operating to support of several hundred thousand people, moving hundreds of miles, with no indigenous logistics infrastructure, and no fixed communications network. The feat that we accomplished in Operation Enduring Freedom (OEF) and Operation Iraqi Freedom (OIF) in the business operation of supplying our forces is unprecedented in the commercial world. Regarding the supply chains, our scope and complexity is not seen in any commercial entity.

This complexity also transcends our business systems. We are in the process of implementing business systems that are, as well, unprecedented in scale and complexity when compared to the commercial sector. Our challenging business requirements, in part, drive this complexity. Furthermore, not only do we have all the same requirements

of a commercial company with regards to changing business practices, we have a unique set of statutory, regulatory, and reporting requirements that exacerbate and multiply the complexity of our transaction systems.

Finally, and a point which I have not heard very often in the past, the business functions are ancillary to the mission of the DoD. In every commercial firm in which I have worked, the business functions were primary, particularly finance. The mission of General Electric is to make money for its stock holders. It does so by aligning its business operations, personnel, and capabilities to maximize its financial performance. As I understand it, the mission of the Department of Defense is to defend the United States of America against its enemies. The job of the Secretary of Defense is to see that mission accomplished. Business transformation is necessary, but not sufficient for the Secretary to be successful in his duties. When Secretary Rumsfeld announced his intentions to transform the Department of Defense, I feel certain that business transformation was central to that intent. Twenty four hours later, our country faced the most significant challenge to its security in several decades requiring his complete attention be focused on defending our country. While he and our senior leadership have remained consistent in driving their vision for transformation, the ability of the Department to focus exclusively on fixing its business operations in the midst of our largest sustained military campaign since Vietnam remains problematic. By the way, I am not convinced that adding another player to the mix will help. Adding complexity to the organization is the last thing I would recommend to you today. I think the work of transformation of business operations falls to me and my colleagues in acquisition,

personnel, finance, and logistics. This is a task which we are all spending our full efforts, while at the same time actively providing support for our service members living in harms way. I have seen great progress made by the DoD in many areas of business transformation in my two years aboard. I look forward to working with the Senate to help accelerate and widen these efforts.

The Key Business Processes

In my estimation, having spent the last two years in full time study of the business of the DoD, I would suggest this committee look into three key business processes to achieve the most "bang for the buck", those being product development (Acquisition), supply chain (Logistics), and the supporting business systems infrastructure (BMMP). I have excluded the personnel management and related entitlements as the issues there are related more to the problems our country faces in the whole regarding health care and benefits. This is not to say that I would suggest you ignore personnel. On the contrary, the personnel involved in these business processes likely comprise 40-50% of the DoD's entire staff.

DoD's Weapon Systems Acquisition

GAO continues to assess weapon systems acquisition as high risk, but it acknowledges some of the positive steps we have taken. I want to be clear that we have made excellent progress in changing how we think about what we call "big acquisition", including how we develop and manage our requirements as well as the acquisition programs to meets those needs. DoD has changed its requirements processes and the acquisition processes in significant ways that emphasize the identification of joint

network-centric capabilities while employing an evolutionary approach to rapidly acquire advanced warfighting capability. Our evolutionary acquisition programs are divided into increments of capability based on stable, well defined requirements; mature technology; and full funding. The anticipated results are reduced cycle time and programs that are delivered on time and within budget. Let me give you some specific examples of the thought process, and how it relates to some of the larger acquisition programs.

- **Future Combat System (FCS).** The budget delays fielding of the initial FCS Unit of Action by four years, while providing for the introduction of advanced technologies developed for the FCS into the current force. Rather than wait for the "final product", we have taken an approach that reduces overall risk to the FCS program, while still allowing the current force to benefit from many of the near-term possibilities flowing out of the program development activities.
- **Shipbuilding.** The new DD(X) destroyer, the CG(X) cruiser, and the Littoral Combat Ship (LCS) are representative of evolutionary acquisition in the context of a family of systems employing common technologies. DD(X) development is the baseline for CG(X) and technologies developed for DD(X) will be installed on CVN-21 and LHA(R) platforms. The fully open architecture Combat Systems Suite of the DD(X) will be the backbone for all future surface forces. In these cases, the budget maintains the integrity of the evolutionary acquisition process, keeping each program in its appropriate place in the development and initial construction cycle.

We are also taking a more corporate view of our acquisition process through the initiation of Capability Area Reviews. These reviews allow senior department officials to review our capability areas from the 50,000-foot level to ensure we are seeing individual programs and systems-of-systems in the integrated and networked operating context for which they are intended. These reviews allow us to identify disconnects and inconsistencies more quickly than we would with an individual program approach and to facilitate early and effective corrective action. We believe this is key to ensuring a comprehensive and integrated approach to achieving the transformed warfighting capabilities that we need.

Part of our overall approach includes responding to joint warfighting requirements in an even more effective manner. Beginning in FY 2006, the Department will initiate transformation of our very successful Advanced Concept Technology Demonstration (ACTD) effort into the Joint Capabilities Technology Demonstration (JCTD) program. The JCTD program acknowledges our commitment to support the joint warfighter, and explicitly takes into account the funding challenges associated with the rapid fielding of new technology. This new program will be based on suggestions we have received from Congress and the GAO, and I believe it will help us to maintain our department-level focus on important joint capabilities and to accelerate acquisition and fielding.

To meet the urgent operational needs of the Warfighters, we created a Joint Rapid Acquisition Cell (JRAC). The JRAC is responsible for assisting in the resolution of immediate warfighting needs of Combatant Commanders' and/or the Military Departments' certified and prioritized Urgent Operational Needs that have been validated

by the Chairman, Joint Chiefs of Staff. The JRAC has already had a favorable impact on 16 critical programs and the reprogramming of over $400M to enhance intelligence gathering and dissemination, quickly identify terrorists, safely explode IEDs, and protect our warfighters.

Another initiative of the Department is the Defense Acquisition Management Information Retrieval (DAMIR) which streamlines acquisition program management reporting. We are re-engineering the very processes by which we gather and report management information concerning acquisition programs. The DAMIR ultimately will enable the OSD, the Military Services, and other participating communities to access information relevant to their missions regardless of the agency or where the data resides. Also, beginning this month, we are happy to say that the Defense Committees will have access to Purview, DAMIR's presentation layer. Right on members' and staffs' desktops, Purview will provide unclassified acquisition information that typically is received in the annual paper copy of the Selected Acquisition Reports (SARs). Future releases over the next year will add additional information. By supplementing this with a hard copy classified annex, we can eliminate the hard copy annual SARs.

- **Systems Engineering Emphasis – Increase the Knowledge Base:** While mentioning these process improvements, I should note that the Department has reinvigorated our approach to systems engineering by issuing comprehensive and well designed policy, revamping our education and training programs, and implementing a robust outreach program to ensure the policies are institutionalized throughout the department and with our industry partners. The primary outreach

emphasis is on individual programs to establish a sound initial and total life cycle program management structure. We expect this to lead to much improved control over our design and manufacturing processes, enhance our analysis of program status, and create an improved knowledge base for management decision making. Through the Defense Acquisition Board, the Department has reviewed many programs where a lack of systems engineering has contributed to cost, schedule, and technical problems. Sound systems engineering practices are critical to our ability to field affordable weapon systems, on time, and that provide the capabilities we need on the battlefield.

- **AT&L's Scientist and Engineers:** Our focus on systems engineering extends to our science and engineering workforce today and in the future. Since 1999 more than 12 major studies warn of the deteriorating situation within the U.S. science and engineering workforce. Last year Congress provided the Science, Mathematics and Research for Transformation (SMART) legislation that authorized the Department to carry out a scholarship program with an employment payback component. To ensure we maintain an effective workforce, the Department proposed making the SMART Pilot a permanent program. We also seek your support in providing additional authorities that will would improve substantially our ability to develop, recruit, and retain individuals who will be critical in fulfilling the Department's national security mission.

In sum, the Department has taken many substantive steps toward improving the effectiveness, focus, and transparency of our weapons system acquisition process. We

have no intention of stopping here, and we will do all that we can to support the needs of our warfighters using the most efficient, responsive systems we can design.

Supply Chain Management

In the supply chain area, I want to first compliment Dave Walker and his staff for their assessments of DoD logistics and supply operations, dating back to the 1990's. I believe GAO has conducted more than 60 studies in this area since 1990—with 13 completed in 2003 and 2004--and the DoD has generally endorsed and implemented their recommendations. The "high risk" area identified by GAO is primarily focused on "Inventory Management." Supply Chain Management is a term as I described earlier in our testimony which goes far beyond the primary area of GAO's concern. It includes all aspects of procurement, supply, distribution, maintenance, manufacturing, and associated systems and processes. As we have discussed with GAO , this term is so broad that we need clarify exactly what the GAO has in mind to fix. So we have done that. . Working with the Office of Management and Budget, we have identified the following areas that are critical to addressing GAO's concerns:

1. Asset Visibility:
    - Improve Asset Visibility across the department. Develop near-term goals to increase asset visibility and long-term goals to achieve total asset visibility.
    - More fully incorporate asset visibility into DoD's logistics business enterprise architecture and DoD's long-term logistics IT system modernization programs.
2. Forecasting:

- Improve Inventory Management (reduce percentage of low-usage inventory, increase availability of high usage, and increase availability of critical inventory).
- Update and improve material requirements process to identify required war reserve stocks and computer models to forecast wartime supply demand and items with long procurement lead times.

3. Distribution:
   - Improve the seamless flow of materiel in support of deployed forces.

The overall effectiveness of the total supply chain was demonstrated in OEF, which began less than a month after the September 11 attacks and removed the Taliban from power in short order. In support of OIF, which led to the overthrow of Saddam Hussein in a matter of weeks, we moved and sustained a ground force farther and faster than ever before. Those accomplishments would not have been possible without an effective total supply chain.

The GAO report notes that DoD currently owns about $67 billion in inventory in 2002. It should also be noted that when inventory management was added to the High-Risk Series in 1990, DoD inventory was over $100 billion and the initial GAO focus was on efforts to reduce the inventory in the wake of the Cold War. When military readiness concerns surfaced in the late 1990's, DoD undertook steps to bolster inventories for critical spare parts. Budgetary limitations and the extended lead times for critical parts—up to the three years for some aviation spares—posed significant

challenges, but the supply chain was able to respond well enough to effectively support OEF and OIF.

The DoD supply chain has been a focus item of mine from the day I interviewed with the Under Secretary of Defense for Acquisition, Technology & Logistics (USD(AT&L)) in 2002. I have led efforts to move towards Knowledge Enabled Logistics. Knowledge Enabled Logistics means asset tracking, conditioned based maintenance, performance based support from our industry providers, lean maintenance in all of the Depots, and integrating the Supply and Distribution folks to focus fully on factory to fighter. The introductions of Joint Deployment and Defense Distribution Operations Centers (JDDOCs) into Central Command in January 2004, and more recently into Korea, PACOM, EUCOM, and SOUTHCOM, led to better-synchronized theater distribution and greatly reduced the goods in flow, while putting warfighter customer needs first. This means Trusted Logistics from the customer perspective, an end to duplicate ordering, and paying attention to retrograding repairs back to the U.S. with the same intensity as getting warfighting capability into theater. We have introduced Unique Identification and introduced changes to the International Standards Organization as a foundation element to knowing the stock, and also Radio Frequency Identification in partnership with commercial industry to manage inventory levels throughout the system, and throughout the theater when fully deployed. Over time all of our purchases that meet certain criteria will come to us both marked and tagged. I think the latest statistics demonstrate positively that we are very close to Trusted Logistics with the performance we have fostered.

Clearly ongoing operations demonstrate both the effectiveness of the Department's supply chain and some areas for continued improvement. Recent achievements include:

- We have integrated and focused the 500 initiatives which Dave's staff identified (and we found when I joined DoD) into four specific strategic initiatives: (1) achieve Joint Theater Logistics Management; (2) transform weapon system support; (3) compress our organically managed supply chain and achieve asset visibility; and (4) modernize our business systems.
- Industry continues to provide exceptional performance based support to our weapon systems. We are realizing 30 to 40 percent increases in materiel availability, a 70 to 80 percent reduction in lead times, and historically high readiness levels for systems deployed in Iraq today.
- Responded as rapidly as possible (given lead time) to improve materiel availability. Today, materiel availability for the Defense Logistics Agency is 88 percent (versus a target of 85 percent) and backorders hit a historic low in March 2004.
- Through aggressive partnering with industry, DLA's cost recovery rate is at a historic low of 15 percent this year.
- Increased the number of recoverable items returned from theater for repair each quarter by a factor of twenty in the past year.

- Established a new contractor-operated distribution depot using a commercial warehouse system in Kuwait in September 2004.

Even with these accomplishments, we have some areas for improvement, including further reducing our response time and variability in that response time. To address those areas the Department will continue to aggressively implement joint theater logistics, performance based weapon system sustainment, lean organic procedures, radio frequency identification, and an integrated end-to-end distribution process. We published our strategy for achieving Knowledge Enabled Logistics on December 10, 2004 and we are currently documenting specific actions and milestones to implement that strategy. We expect to publish those actions and milestones as a "Logistics Roadmap" in July 2005.

Business Systems Modernization

Although recently designated by GAO as a "High Risk Area" in its January 2005 report, the Department's approach to Business Transformation is moving in the right direction. On February 7, 2005, the Deputy Secretary established the Defense Business Systems Management Committee (DBSMC) and designated USD(AT&L) as his Vice Chairman. The Committee will oversee business transformation and ensure funds are obligated for defense business systems modernization in accordance with the requirements of the Fiscal Year 2005 National Defense Authorization Act (NDAA). Additionally, USD(AT&L) has assumed direct responsibility for the Business Management Modernization Program (BMMP).

As described in our March 15, 2005 Annual Report to the Congressional Defense Committees, we are on track with establishing a strategic and integrated plan for business transformation with specific goals, measures and accountability mechanisms. Our efforts to ensure effective control and accountability over the Department's business transformation address many of the concerns and recommendations identified in the recent draft GAO report (GAO-05-381, March 16, 2005), on DoD's Business Systems Modernization.

These actions make sense because most of the processes that support financial management and the Department's goal of financial transparency reflected in clean audits are AT&L processes. Additionally, having the Deputy Secretary of Defense and the USD(AT&L) overseeing this program sends a clear message regarding senior leadership involvement. Placing the program under acquisition oversight will instill program discipline as we move from focus on architecture development to rapid implementation of business capabilities.

We have also delegated responsibility for review, approval, and oversight of defense business systems to the Approval Authorities specified in the 2005 NDAA. As part of the investment review board process, we are defining a management structure that clearly defines the relationship between OSD and the Components for investment review responsibilities. I believe these steps will ensure the management accountability and sustained engagement by senior DoD leadership recommended by GAO in the report I mentioned earlier.

We have made significant progress to date on creating data standards and strategies, translating over 145,000 requirements into business rules for financial compliance, developing an initial Business Enterprise Architecture, and improving control of IT spending. Additionally, we have made great gains in defining processes & standards for Unique Identification as a means of achieving Total Asset Visibility, developing a Standard Financial Information Structure (SFIS) that will enable financial transaction traceability, and creating a single face to industry for all components using information technology.

As you are aware, a number of DoD Components are making substantial investments in Enterprise Resource Planning (ERP) systems. In addition to ensuring that we provide the services with data standards and business rules to ensure interoperability among these systems, and complying with DOD-wide Business Enterprise capability requirements, USD(AT&L) is working closely with the ASD(NII) and the business mission area owners to ensure that these transformational systems are acquired properly and that their potential benefits are achieved as soon as possible. Our initiatives in this area include (1) establishing Blanket Purchase Agreements for Commercial-Off-the-Shelf (COTS)/ERP software and associated system integration services under the Enterprise Software Initiative, (2) publication of a Defense Acquisition Guidebook section on best practices in acquiring COTS software, and (3) mapping the decision points and information requirements of the DoD Acquisition Framework to the natural decision points of the COTS/ERP acquisition process. Finally, as part of the realignment of the

BMMP into AT&L, we are establishing an ERP center of expertise. This team of subject matter experts will work with the components to further encourage sharing of best practices, reuse of capabilities already developed, and rapid implementation of DOD rules and data standards.

We are working to address GAO's concerns with the DoD's business system inventory and enterprise architecture. As we stated in our March 15 Report, DoD has improved the accuracy of its business system inventory. A standard definition of a system is being used to ensure a consistent inventory and business systems are now being recorded in a single repository, the DoD Information Technology Portfolio Data Repository (DITPR). We are on track to complete a Business Enterprise Architecture sufficient to clearly define the DOD Business Enterprise and its associated capabilities and systems, as well as the component Business Enterprises and their capabilities and systems, by this fall as required by the 2005 NDAA.

While significant work remains, I am confident that the strategy we have adopted and the steps we have taken will achieve the transformation we desire and account for shortcomings identified by GAO in their recent reviews.

To complete the thought on who should play the role of Chief Management Officer (CMO), I believe this could to counter to where industry has been going, and may further remove the Secretary of Defense from vital and timely information on the

workings of the Department. I am told that this has been tried once before. I would ask that

Conclusion

Before closing, I would like to note how extremely proud I am of the team that is dedicated its lives to transforming DoD's business operations. One metric of their ability and dedication can be found in the awards they win. Some highlights of these are: The Defense Acquisition University was recently recognized by the American Society for Training and Development at the #1 training organization for 2004 in America. Ms Lisa Romney, one of AT&L's procurement analysts, was selected as a Fed 100 winner. Ms. Mae DeVincentis of DLA was recognized as one of CIO Magazine's 2004 CIO 100 winners; Defense Supply Center Columbus employee Mr. Hance Barnett received the Military Packaging Hall of Fame award from the National Institute of Packaging, Handling and Logistics Engineers; Mr. Ted Glum, Director of the Defense Microelectronics Activity was selected as the 2005 Federal Laboratory Consortium's Laboratory Director of the Year; USCENTCOM's Deployment Distribution Operations Center and the USMC's 1st Force Service Support Group received the Supply-Chain Council's Award for Excellence in Supply Chain Operations; and the Light Armored Vehicle Lifecycle Logistics Support Tool (a Commercial Technologies for Maintenance Activities project) was honored with the National Center for Advanced Technology's 2004 Defense Manufacturing Excellence.

In closing Mr. Chairman, thank you for the opportunity to testify before the Committee about our business transformation. I would be happy to answer any questions you and the Members of the Committee may have.