

From: Lord Levene
To: Secretary of State

DEFENCE REFORM – THIRD ANNUAL REPORT

Following the decision to implement my report on Defence Reform in 2011, I agreed to take stock of progress on an annual basis thereafter. The findings of my third such review are set out below. They are based on a range of evidence including personal discussions with all the most senior figures in Defence.

In my two previous stocktakes, I have focussed on the progress achieved against the specific issues and recommendations in my original report. I continue that theme below.

But this year, I have sought to go further. Improving the management of Defence is an unceasing endeavour. Defence Reform has, in my view, been a very important chapter of this continuing story, but now is the right time to be asking 'where next?'. I have therefore included recommendations on how to take Defence Reform to the next level: how to make it work effectively against the management challenges confronting MOD over the coming year (during which it faces both a Strategic Defence and Security and a Comprehensive Spending Review), and in the longer term as it uses the mechanisms of the delegated model to deliver successful outcomes. My review this year has looked in more detail at areas not covered extensively in the first two exercises, including the future of equipment acquisition and support, and the provision of infrastructure services.

Overview

Building on the encouraging progress noted in my previous stocktakes, there is now clearer evidence that the recommendations in my original report are being implemented and becoming firmly embedded across Defence and its organisational psyche. I do not say this lightly. Defence Reform was always much more than a set of changes to decision-making structures and processes. It embodied a new and different way of thinking about how decisions were approached, taken and accounted for. This review has satisfied me that the great majority of Defence, including its leadership at the very top, now embraces this new management philosophy, and that the organisation as a whole (including, increasingly, its future leaders) now absolutely 'get it'.

That said, there still remains a way to go in implementing all the changes in my original report, and further still fully to embed its underlying spirit, and to stress test the reforms against 'real world' funding and political pressures (the first significant examples are now starting to emerge). I highlight below some of the further steps I think are necessary on MOD's continuing journey of change. I do so not because Defence Reform is in danger of failing, but because it is close to succeeding in delivering fundamental institutional reform to ensure Defence is effectively and efficiently managed over the next five years and beyond.

The following sections set out my more detailed conclusions, based as last year around the key themes of Defence Reform.

A smaller more strategic Head Office

MOD Head Office has continued to reduce in size¹, and more importantly, there is clear evidence that it is actively striving to increase its strategic focus, and to avoid becoming involved in day to day TLB business. This is not always easy, especially if there is close Parliamentary or Ministerial interest in particular TLB issues. But I am satisfied that the right attitudes and behaviours are increasingly in place, and that the overall direction of travel is right. I am also pleased by the growing leadership maturity of the Defence Board; considered among the best in Whitehall, this now looks, feels and operates like a commercial board, and is a great improvement on the Board of four years ago. Three key enablers for this have been: the presence of independent and experienced non-executive directors on the Board to help challenge and guide the executive; the successful operation of the Armed Forces Committee below Board-level, acting as the forum in which Single and Joint Service views can be fully discussed; and, despite worrying shortcomings in overall management information within Defence as a whole (see below), there have been significant improvements in the substance and presentation of the pack presented at Board meetings.

Although the Head Office function is undoubtedly much improved, I do have areas of concern. The management of a potential in-year overspend during 2014/15 has not been fully in line with the principles set out in my original report, in that savings have been sought from underspending TLBs to offset anticipated overspends in others. I recognise there are special reasons for this, and full in-year financial management (and the associated financial disciplines) is planned to pass fully to TLBs in April 2015; nevertheless, for the future, it is crucial that Head Office avoids disincentivising TLBs who are managing their resources prudently. More generally, there are aspects of business outside finance (for example in the Security Policy and Operations area²) where Head Office might seek to become more 'muscular'. Defence Reform was about empowering TLBs, but it was certainly not intended to disempower the Head Office in its key role of setting corporate policies, priorities and direction for the greater good of Defence. The creation of a Head Office Management Group under PUS and VCDS to provide focus and co-ordination is a welcome step forward, as is the new stronger regime for central oversight of all aspects of Defence nuclear business. But I sense there is further to go in these and other areas in reinforcing Head Office's leadership role across-Defence, and generating an understanding in TLBs of how they best respond to this direction. Finally, I remain concerned that MOD still has more Ministers (six) than it really needs, and this runs a serious risk of diverting Head Office focus unnecessarily onto matters with which it need not be concerned. In my view, failure to address this issue sends out the wrong signal.

¹ By April 2015 Head Office will have reduced by 600 posts (25%) compared with 2011.

² Ensuring that the single Services place the appropriate priority on Defence Engagement activities and provide suitably capable people for international postings.

Delegation and empowerment to the TLBs

Since my last stocktake, TLBs have been further empowered with so-called 'full operating capability' declared at April 2014. This was achieved through Head Office setting a more directive Defence Plan than previously, and by TLB Command Plans which address how the requirements placed on them will be delivered. As a result, TLBs are - on the whole - seen to 'own' their plans, take more responsibility for delivery and are much more active in determining their own priorities. Most of the military Chiefs told me they now felt personally empowered, with the Chiefs of the Air and General Staffs clearly depicting themselves as Chief Executives actively running their Service, and geographically located with it rather than in London. This is precisely the vision set out in my original report, and I welcome the extent to which it has been enthusiastically embraced. I recognise that different structural factors (including constraints around submarine acquisition and relating to industry) somewhat limit the management flexibilities available to the Chief of the Naval Staff, but am pleased for example that settlement of many of the strategic issues around UK shipbuilding capacity has also allowed financial responsibility for the aircraft carriers to be passed to him. I hope that in time the Navy too will feel able to move more to the management model being set in the other two Services.

The forthcoming Strategic Defence and Security Review (SDSR) presents an important opportunity to reinforce and develop both the principles and practice of delegation. Head Office must rightly lead the strategic re-analysis of the country's Defence needs, and plan the most effective way of delivering them within the resources that can be made available. This will require close consultation with the TLBs, but must clearly not be dictated by agendas within, or a spurious sense of needing to balance between, the single Services. Once the overall plans and resources have been set, the challenge for Head Office will be to translate these into the outputs each TLB will need to deliver, and then allow each Command to deliver these as it sees fit. This needs to be done with continued strict financial discipline to remain within allocated budgets, but otherwise I would hope with clearer delegations and still more management freedom than now. I would also hope that the TLBs will find ways of delegating relevant aspects of decision-making further in their own command chains.

Creation of Joint Forces Command (JFC)

Joint Forces Command continues to mature and is now at a full operating capability. It remains lean and agile, and is progressing well from a disparate set of functions to a single collegiate organisation. There is clear evidence that the improved focus it is bringing to the key technological 'enablers' of modern warfare is both vital and strongly supported by the single Services. Overall the relationship between JFC and the single Services seems to be maturing well, as evidenced by unanimous support at the Armed Forces Committee for additional JFC funding in the last budget round. I am particularly pleased to see the strong leadership being delivered by a new 3-star CIO from the private sector to the whole area of Defence information technology, which badly needs the radical, vigorous and iconoclastic approach he is taking.

The challenge for JFC, particularly over the next year, is to consolidate and build on these positives, to reinforce further its overall position within Defence (including

improving its current manning level of only 84%), and to work with Head Office in giving prominence in the SDSR to both the importance of joint enablers, and key new areas of potential JFC growth (eg. strengthening various intelligence-related capabilities, not least in response to the advent of 'big data').

Stronger financial and performance management

Financial management is certainly much stronger in MOD than three years ago. Defence Reform was, in large part, about ensuring that Defence never again had an unaffordable, overheated programme. There is increasingly compelling evidence that this has been achieved. Financial pressures are a fact of life, but they are now controlled and managed, and the responsibilities for this are now much clearer. MOD's reputation across Whitehall, and in particular with the Treasury and the Cabinet Office has improved very substantially as a result. If anything, the Department may have over-corrected and consequently underspent in each of the last three years, albeit with some flexibility to carry forward these surpluses into later years. Now that firm financial control has been established, however, the MOD is rightly embracing a prudent degree of 'over-programming', against the near-certainty that some elements of planned spending will always fail to materialise.

In relation to organisational performance management, the evidence points to a mixed picture. The regime for holding TLB holders to account has been in place for two years. There are now also stronger regimes for holding Senior Responsible Owners of major capability or change programmes to account, and the Head Office Management Group has started to do this also for so-called Defence Authorities³. These are positive developments, but I am concerned that the actual processes may not quite have sufficient rigour. I recognise that the regime for Holding to Account in MOD is necessarily still evolving, and this will continue as Defence Reform beds in further. But while I do not advocate an inquisitorial approach, these sessions do need to become more than 'two-way dialogues'; if things have not gone as intended and individuals are judged to be failing, there does ultimately need to be the threat of some kind of adverse consequence. Sacking underperformers may be a less ready recourse than in commerce, but it should remain an option, and thought should be given to establishing a framework of other 'visible' sanctions that MOD is prepared to use where necessary: for example, imposing central financial management on overspending TLBs, or removing SRO status from persistently failing programme leaders.

The quality of management information remains a systemic weakness across Defence, notwithstanding that the Board is now getting a better product. This said, improvements have been made, and more are in train under both the new CIO and the planned programme to improve Defence Corporate Services generally. These will, however, need to be driven through with a strong and sustained focus from the Defence Board and pushed down to TLB level and below.

³ Defence Authorities are individuals appointed by, and accountable to, PUS. They are responsible for setting rules and standards across Defence in specified functional areas such as finance, safety and security.

Acquisition, Infrastructure and Corporate Services

Good progress that has been made in the last year around the future organisation and operation of DE&S: its new status as a 'Bespoke Trading Entity' within MOD, and the strengthened governance arrangements under an independently chaired commercial-style Board, seem right; the quality and morale of the top DE&S management team is good; and I congratulate MOD on securing extensive new pay flexibilities. These reforms augur well for the future. They are still at an early stage, however, and the focus now must be on getting them properly developed and implemented, and equally crucially on ensuring that TLBs have the capacity, capability and confidence to act as truly intelligent customers; the evidence to date on the latter is generally promising but still somewhat mixed across different elements of the customer base. I also welcome DE&S' review of the delivery of storage, distribution and other logistics services, with a view to greater private sector involvement. This seems right; DE&S needs to maintain a strong focus on its core business of equipment acquisition and support.

The Defence Infrastructure Organisation (DIO) has also undergone a period of significant change over the last year, with the introduction of a private sector business partner and new governance arrangements. Here I am less convinced that MOD has yet got it right. I welcome the clear intention to look at creating an 'incorporated' model for DIO in 2016, but am concerned about yet more years of uncertainty and would urge an earlier transition; the evidence is that DIO lost a significant amount of its delivery focus during a protracted period of introspection about its organisation, and I am worried that this could now continue. A strong outward delivery focus needs to be regained quickly, and it is important that the new business partner should recognise this. More strategically, TLB aspirations for infrastructure funding far outstrip available resources. Although there are new mechanisms to determine pan-Defence investment priorities, the only sustainable solution in the longer term, as already demonstrated in the equipment sphere, is to take hard programme reduction decisions and then give TLBs the financial incentives to use infrastructure budgets more wisely in future.

This year has also seen the successful conclusion of the MOD's Corporate Services Transformation programme, which involved the creation of Defence Business Services (DBS) as a single shared-services delivery organisation under a strategic management partner arrangement with the private sector. The savings and other benefits anticipated in 2011 have been achieved. But even bigger challenges lie ahead. The new programme being established for the future of DBS up to 2020 and beyond will need to look radically at what corporate services MOD really needs and how these can be delivered to higher standards at significantly less cost; the programme also has a key role to play in improving corporate management information within MOD.

Personnel Issues

Progress has been made in a number of important areas. A new Defence People and Training Strategy and a Defence People and Training Board have been put in place. Civilian and military HR policy has now been brought together under the Chief of Defence Personnel (CDP). Longer tour lengths are increasingly becoming the

norm at senior levels. And I welcome the innovative ways by which DE&S is hoping to use its new HR flexibilities to remove some of the structural and cultural barriers (inherent in the standard Civil Service model) to recruiting, retaining and rewarding talented people.

But much of this reform has yet to deliver tangible change, and there still seem to be formidable obstacles to delivering the Whole Force Concept and improvements in people capability envisaged in my original report. There are weaknesses in management information, and hence the Department's ability to take a long term strategic view on skills and the numbers. The role and powers of the CDP in relation to the single Service personnel authorities does not seem to have been fully resolved. There are recruitment and retention problems both generally, and more acutely in certain military specialisms and in building up Reserve numbers; these issues should be highlighted for early resolution. I also worry about the government's strong attachment to maintaining absolute numbers of Regulars in each of the Services. I understand the 'political' drivers for this, but I believe such thinking is a significant and artificial constraint on Defence capability. I hope that, beyond the next election and the SDSR, MOD will be able to give the Service Chiefs genuine flexibility, within a fixed budget, to trade between Regular, Reserve, Civil Service and contractor manpower, if they think that will allow them to deliver greater and more cost-effective military outputs.

Despite the complexity of some of these problems, I remain encouraged that Defence Reform is giving MOD insights, options and levers around personnel that were not previously available, and that this is readily embraced at senior levels in Defence. The challenge now is for MOD to apply to the management of its people the same senior focus and all-round effort that has successfully transformed its financial position. And in doing so, I believe it should consider further changes to the way its people processes work at the very top: could the Defence Board for example be given a choice of individuals to become a Service Chief, selecting the one whose personal 'manifesto' most suited prevailing corporate priorities; and to reinforce their standing as 'Chief Executives', should all Service Chiefs (like Permanent Secretaries in future) be sent on stretching and highly intensive MBA training courses before taking up appointment?

Way Ahead and Suggestions for SDSR Consideration

In summary, the reforms I proposed in 2011 were a mechanism to deliver both effective and more efficient Defence. Based on the evidence above, I am increasingly convinced that the management of Defence is now significantly more effective; the acid test for the future is how far they help to unlock further business efficiencies. Currently signs are generally positive, but on this longer term journey, they remain indicators, not proof of success; and the personnel area requires particular attention.

In the meantime, the SDSR and associated Comprehensive Spending Review (CSR) may put the delegated model under 'combat stress'. It will, for example, seriously test Head Office's ability first to formulate and decide on strategy (some of it possibly contentious within Defence and publicly) without the exercise becoming dominated

by single Service agendas; and then to oversee its delivery through an even more disciplined delegated delivery framework.

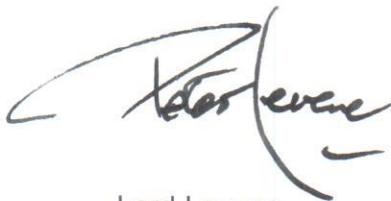
Building on the analysis above, the key challenges for the coming 12–18 months will therefore be to:

- reinforce and enforce Head Office's role and capability in setting corporate policy and strategy;
- move to a fully delegated framework in which all TLB Holders fully recognise their responsibility to live within the resources delegated to them, and the Service Chiefs visibly act as Chief Executives;
- move quickly to ensure DE&S and DIO in particular (but all other enabling organisations with MOD) become more responsive and cost-effective in delivering support for Defence outputs;
- give the Service Chiefs greater flexibility to determine the size and shape of their Services in order to deliver the required outputs within their delegated authorities;
- find practical ways to make the holding to account process stronger and more rigorous; and
- in practical terms most importantly, to apply senior effort and focus to resolving a complex nexus of personnel-related issues.

Defence faces these challenges, however, from a position of strength. I have been impressed with the fundamental transformation the Ministry of Defence has undergone in the last four years. It has changed, if not beyond recognition, then certainly well beyond my expectations when I published my original report. And to have done so against a backdrop of budgetary pressures and a high operational tempo for all the Services makes the achievement all the more laudable.

Looking ahead to the SDSR and CSR, MOD will, like all Departments, face significant financial challenges. But I believe it now has all of the necessary mechanisms to deliver improved efficiency, and should therefore resist as far as possible calls for further major process or organisational 'surgery' (although I would still press for early change in the DIO). The focus should instead be on making the existing mechanisms work properly, and taking them to the next point of logical evolution: for example, with a stronger philosophical, linguistic and practical focus on outputs rather than input (in other words, the military capabilities required rather than force structures or readiness needed to deliver them).

I think that this year's exercise has underlined to me the need to keep the process under constant review. If you agree, and would like me to continue that review into 2015, I would be happy to do so.



Lord Levene
5 December 2014