

DEFENCE REFORM – FOURTH ANNUAL REPORT

1. In the four years since the advent of the Defence Reform Programme, the Armed Forces and the civilian members of the Department have succeeded in transforming the work and achievements of the Department in a number of the most critical areas of business and operations.

2. These achievements are set out in the 3 annual stocktakes¹ I have submitted since then, but can be summarised under the following headings:

a. Top-Level Decision Making

The creation of a new and smaller Defence Board, chaired by the Secretary of State, together with clarified roles and responsibilities for the PUS and CDS, has made a demonstrable improvement to decision-making at the top of the organisation.

b. Head Office

There has been a major reduction in the size of Head Office of 25% compared with 2011 and effort made to increase its strategic focus.

c. The Services

Important changes have been achieved in the management of the Services, with the Service Chiefs starting to shape, own and be held responsible for their performance and developing their capability as “Intelligent Customers”.

d. Financial Management

Financial Management is now much stronger than 4 years ago; and the Department’s reputation across Whitehall has improved substantially as a result.

e. Joint Forces Command (JFC)

The successful creation of JFC has brought an improved focus to the key technological ‘enablers’ of modern warfare.

f. Defence Business Services

The creation of DBS as a single shared-services delivery organisation, under a strategic management partner arrangement with the private sector, has laid the foundation for the future development of the delivery of the Department’s Corporate Services up to 2020 and beyond.

¹ Defence Reform Steering Group – First Annual Report dated 30 November 2012
Defence Reform – Second Annual Review dated 13 November 2013
Defence Reform – Third Annual Report dated 5 December 2014

g. Management and use of military and civilian personnel

I have been encouraged that longer tour lengths are increasingly becoming the norm at senior levels. This allows the individuals to bring their expertise to bear, enhances continuity and a corporate perspective, and makes it easier for individuals to be held to account for their decisions and performance.

3. This extensive programme of reform has been extremely challenging. Its timely and successful execution reflects considerable credit on the Department, and in particular on the senior leadership who have driven forward change on a breadth and scale at which most organisations would falter. Overall, MOD has achieved the great majority of the reform programme I set for it in 2011.

4. Where the Department now needs to concentrate to complete the Defence reform agenda is around changing behaviours. This is not surprising. This is the really hard part in any reform programme and, as I made clear in my 2011 Report, it is where the Department has failed in the past.

5. In undertaking this further review of progress you asked me² to probe harder and in more detail on these 'softer' issues, and also at some of the longer term aspirations of the 2011 report. I conducted this further review through a number of interviews with the senior leadership, and by looking in more detail at some of the issues that were raised. I attach at Annex A my assessment against the specific questions that you posed; but, to support the Department in grasping the nettle of behavioural change, I have identified 5 core recommendations.

6. These recommendations get to the heart of the remaining obstacles to full reform and are set out below. Further detail of the context and underpinning logic is provided at Annex B, but the nature of the challenge will require just as much determined leadership to drive the tough decisions that are required as has been shown with the Defence Reform agenda so far. The recent budget settlement, providing stability for the Defence Budget for the next 5 years, reflects the political importance attached to a stable Defence programme and the increased confidence in the changes that Defence has made in financial management. The opportunity for the Department is to use the financial security created to address the systemic issues which remain, which are both cultural and political, and deliver the sort of sustained reform which has eluded Defence for a generation.

The Senior Structure

7. There have been major reductions in the number of Military and Civilian staff employed over the last few years; but there has not been a commensurate reduction in the number of senior staff or Ministers (see Annex B for details). There are a number of reasons for this. In part it reflected the

² 4.1.3.5 dated 20th March 2015

need in the early stages of Defence Reform for strong top-down leadership; but the number of senior staff also drives a level of activity and process that is inefficient and undermines personal accountability. The next stage in the process should therefore look at simplifying the processes and reducing senior structures.

8. This is not a criticism of the calibre of current Ministers or senior officers and officials, who are working hard and operating well, but simply reflects the rigidity of the existing structure. The central aim should be to increase the speed, flexibility and agility of MOD's underlying decision processes. So, while MOD must decide the quantum for itself, sizeable reductions in senior posts across Defence are required to energise and reinforce a wider streamlining of processes and to deliver a programme of genuine empowerment of people at middle management grades.

Recommendation 1: As part of a wider programme of process simplification and staff empowerment, the Department as a whole should now reduce its top structure, with sizeable reductions in the number of Ministers and senior officers and officials in Head Office and in the TLBs.

Managing by Outputs

9. Building on the improvements that have been made in financial management, there now needs to be a renewed focus on outputs, not least in the planning and resource allocation process, on which the operating model is founded. This will involve overcoming both cultural and political challenges, which are to an extent mutually reinforcing. There will necessarily continue to be some constraints placed by Head Office on the ability of delegated budget holders to flex within their budgets, for example to meet Parliamentary or Treasury controls (although the more controls there are potentially inhibits value for money). Changing the process properly to focus on the outputs to be delivered, however, should focus attention on alternative measurements of military power, allow Head Office to move away from the more traditional focus on inputs such as manpower numbers and enable an increased emphasis on efficiency of the system including how supporting functions should be delivered.

Recommendation 2: Building on the new Defence Strategic Planning Framework, the Departmental planning and resource allocation processes should be further simplified and adjusted to focus on clearly defining the outputs to be delivered within the available budget, and setting the control framework to allow the delegated budget holders to be able to flex within their budget to deliver the required outputs.

Recommendation 3: In parallel, the Head Office Review should identify practical ways to use the reformed planning and resource allocation processes to improve the ability of Head Office to drive increased efficiency across Defence.

End-Year Flexibility

10. A consistent refrain from many of those I interviewed was the counter-productive effect of the absence of a degree of certainty over the ability of the Department to carry-forward to a subsequent financial year funds that are not spent in-year. This is an age old problem which I thought had been finally resolved but clearly it has not. The Treasury needs to understand the severe downside of what is a very short term approach to financial management. In the case of Defence with a high volume of multi-year capital projects, this is a major constraint that impacts negatively on the successful operation of the new model.

11. If a contractor fails to deliver and a milestone payment is not made the budget area is faced with the financial consequences of either spending the resources on a lesser priority or having an underspend in-year and a potential overspend to be managed the following year when the milestone payment becomes due. The effect of a lack of confidence in the ability to carry forward the funds to the following year is to drive perverse behaviours and sub-optimal decision-making and ultimately to undermine value.

12. Current HM Treasury policy does allow the Department to carry forward a forecast underspend from one year to the next, subject to a limit of 0.75% of Resource DEL (~£190M) and 1.5% of Capital DEL (~£105M) and as long as the underspend is forecast in Supplementary Estimates in January. In 2012/13 and 2013/14, however, the Treasury granted MOD exceptional flexibility to carry forward a total of £2.9Bn to the subsequent years.

13. This exceptional agreement to carry-forward the underspends to subsequent years was of real benefit; but it would have been more valuable if there had been confidence at the beginning of the year that such underspends emerging at the end of the year could be carried forward (and not just those forecast in Supplementary Estimates within current limits). The improvements that have been made in the financial management of the Department, together with the Government's commitment to a stable Defence Budget for the lifetime of the current Parliament, provide an important opportunity to formalise the practice of allowing full end-year flexibility to ensure the Department delivers value from the Defence Budget.

Recommendation 4: The Treasury should formalise with the Department the practice of allowing full end-year flexibility.

Infrastructure

14. Another facet of the difficulties in moving to a proper focus on outputs in the planning process has been the continued difficulties and delays in bringing infrastructure within the principles of the new operating model, concerns to which I have drawn attention in my previous reports. It is extremely disappointing that four years after my original report there is still not an

independent chair of the DIO Board. The DIO has not performed well. More fundamentally, however, a simpler arrangement for managing Defence Infrastructure needs to be introduced with a clearer customer-supplier relationship. As with the equipment programme, early decisions are required to reduce the size of the Defence Estate; but then a simpler arrangement for management of the estate should be introduced where the TLBs bear the full cost of ownership of the estate that they use, with Head Office setting the principles (which should include minimum standards that need to be met) and DIO acting as design authority and delivery agent. Given the delays there have been in addressing this up to now, this needs to be managed at pace and strong leadership will be needed to take the difficult decisions that are required properly to put Defence Infrastructure on a sustainable footing in the next few months.

Recommendation 5: Early decisions should be taken to reduce the size of the Defence Estate and simplify the processes for its subsequent management with TLBs bearing the full cost of the estate that they use. The management and oversight of the DIO should also be urgently improved.

CONCLUSION

15. I identified in my 2011 report that the hardest part of any reform such as this is effecting the changes to behaviour necessary to reinforce the organisational and process improvements. There have been some impressive changes that have been made to the management of Defence over the last few years. These have led to some changes in behaviours, and some further changes are in hand; but there is further to go and the small number of specific recommendations I have identified are intended to get at the core behavioural resistance that is limiting the pace of reform and delivery of the full benefits from the new operating model; and thus re-enforce and re-energise the direction of travel on which the Department has embarked.

16. This is tough for any organisation, not least one that has already achieved so much; but there is a great opportunity if still more can be achieved. This would maintain the MOD's reputation of being one of the leading Departments in Whitehall in keeping up the pressure on numbers. The recommendations I have identified need to be driven for full implementation through the Strategic Defence and Security Review to match the Government's clear financial commitment to Defence, ensuring it is not wasted and, more importantly, is shaped for best effect against the myriad of strategic security challenges the nation potentially faces.

Lord Levene
November 2015

COMMENTARY ON SPECIFIC AREAS

<p>1. As well as being smaller, is the Head Office now stronger and more strategic?</p>	<p>There remains some way to go still for the Head Office properly to be operating as the smaller, stronger and more strategic Head Office required for the effective operation of the new operating model.</p> <p>I was advised that the Review of the Head Office will be addressing this; but, as identified in the main Report above, this will require top-level leadership to drive the fundamental changes in process that are required, with a greatly increased focus on individual accountability.</p>
<p>2. How well are the FLCs implementing the devolved responsibilities they now have? Do they have the clarity of direction, business expertise, MI, change management skills and overall governance they need? Are they acting as intelligent customers of DE&S and DIO? What tangible difference has it made?</p>	<p>All the FLCs have embraced, to varying degrees, the changes that are required and are embarked on a journey to develop the skills and expertise required.</p> <p>In respect of their role as intelligent customers of DE&S, the building blocks are in place and the key challenges are the provision of timely and accurate Management Information and the pace of transformation within the DE&S; but I was given examples where the FLCs had already been able to adjust equipment priorities to reflect their requirements.</p> <p>In the case of the DIO, much more attention is required. It is taking too long to balance the programme to available resources and to introduce a system whereby the users of the estate bear and feel the full cost of ownership.</p>
<p>3. Is there a good plan for providing one version of the financial and performance truth?</p>	<p>There are reasonable plans for providing improved financial management information, together with related manpower information.</p> <p>The key shortfall is in accurate and definitive performance data, particularly in terms of delivery against outputs which, as set out in the main Report, remains a systemic shortfall in the Departmental planning process.</p>

<p>4. Have we been sufficiently radical in implementing the Whole Force Concept, or in other aspects of people policy? If not, what are the blockers and how can we best overcome them? Should TLBs, for example, have greater power to choose flexibly, according to business need, between different types of personnel?</p>	<p>As addressed in the main Report above, the opportunities provided by the Whole Force Concept have not been fully adopted. At its root, the key blocker is the continuing preoccupation to try to control individual manpower categories (whether military or civilian) rather than allowing the Service Chiefs to be able to flex between manpower types to deliver the outputs placed on them within the budget allocated.</p>
<p>5. How can we best build on the success of JFC?</p>	<p>The establishment of JFC has been a success and there are two main challenges which I would highlight moving forward. The first is the difficulties faced by JFC in improving its current manning level (of 88%). This is a symptom of the “input-based” approach to resource allocation to which I refer in the main Report above; and which I would hope that the recommendation I have made would help to address.</p> <p>The second is the risk that JFC becomes a victim of its own success with a temptation to give it anything which requires coordination between the Services, rather than considering where a lead command rather than a properly joint approach would be more appropriate. As it was put to me, the debate should move from ‘Jointery by consent’ to ‘Jointery by design’.</p> <p>There are, however, some areas where further development of the scope of JFC should be considered. For example, adjusting all operations to fall under Joint Command as a default; or looking at the potential synergies between DSTL and the Doctrine Centre within the Defence Academy.</p>
<p>6. Can we ‘de-enrich’ rank structures in the Commands and in Head Office to produce a ‘flatter’ organisational and management model?</p>	<p>As addressed in the main Report above, there needs to be a sizeable reduction in the size of the senior structure, building on a revised functional analysis of how the Head Office should operate.</p> <p>More widely there needs to be greater attention paid to ensuring that the drawdown in senior staff is at least as great as the overall personnel reductions up to 2020, with the principle of delegation and accountability applied further within the TLBs.</p>

BEHAVIOURAL CHALLENGES

A. The Management of Defence

1. There have been major reductions in the number of Military and Civilian staff employed³ over the last few years and the then Secretary of State set targets in 2012 to ensure that the drawdown in senior staff was proportionately equal to, or greater than, the overall personnel reductions across the period from 2010 to 2020. As of April 2015, the Department has still to meet these targets⁴. In addition, the proportion of two stars and above in relation to more junior staff has worsened in recent years⁵; and the figures compare unfavourably with others⁶. Furthermore, notwithstanding the recommendation in my 2011 Report that the number and responsibilities of MOD Ministers should be reviewed to align with the new model, the number of Ministers is now greater than it was in the 1980s.

2. This is not just a numbers issue. The number of Ministers and senior officers and officials drives a level of activity and process that risks undermining personal accountability; and sends the wrong message to the organisation. The effect has been to leave in place processes that involve too many people checking the work of other people; too many compromises being made to keep everybody happy; and too much time being taken to reach decisions. This view is widely recognised within the Department, but in some areas the organisation is still overly focused on process for its own sake. Yet, evidence suggests that many of the Department's best decisions⁷ have resulted when these processes were heavily abbreviated or even bypassed, thanks to clear vision and strong leadership. When these are not present, process prevails by default.

3. There are, however, numerous areas where progress has been or is being made. I was pleased to see good examples of how the delegated model has been adopted effectively in some of the Front Line Commands. Both Army and Air are starting to think imaginatively and creatively about reprioritising the resources they have available. It will be important to ensure that available

³ The department's workforce has reduced by 61,460 between 2010 and 2015, made up of 33,770 military personnel and 27,690 civilian staff. (*NAO Report on Strategic Financial Management in the Ministry of Defence, 17 July 2015*)

⁴ There were 447 senior military staff (1 star and above) against a target of 429 and 144 senior civil servants against a target of 135.

⁵ For military staff, the ratio was 1:1,454 in 1994 and had remained broadly constant at 1:1,457 in 2010 but had worsened by 22% to 1:1,139 at April 2015 (*Defence Statistics*). For civilian staff the ratio was 1:1,108 in 2010 and had worsened by 15% to 1:945 at April 2015 (*ONS*).

⁶ The average ratio for senior officers in the US military for FY14 was 1:2,757 (*US DoD Defense Manpower Requirements Report*). For civilian staff, the comparable ratio at April 2015 for other Government Departments was DWP 1:1,325; HMRC 1:1,413; Ministry of Justice 1:1,134 (*ONS*)

⁷ For example, the difficult decisions needed to eliminate the £38Bn funding gap were taken in under 3 months; but decisions on reducing the size of the defence estate to balance the cost of infrastructure within available resources are taking considerably longer and are still not concluded after 4 years.

incentives are properly aligned to ensure that these positive behaviours are reinforced with clearer disbenefits where old habits still persist. The reduction in the number of 4 star posts in the Services has helped deliver a change in culture, but the principle of delegation and accountability generally needs to be continued further and a greater emphasis placed on exceeding the targets for the reductions in the senior staff already set.

4. I was told about the planned Review of Head Office, which will be important in setting the tone for how the Department as a whole operates. It will need top-level leadership to drive the fundamental changes in process that are required, with a greatly increased focus on individual accountability properly to deliver the vision that I outlined in my 2011 Report of a smaller but stronger and more strategic Head Office. This should not be a numbers-driven exercise; but if it is to successfully address the functions required of the Head Office in the new operating model in an efficient and effective way this should result in a sizeable reduction in the number of Ministers and senior officers and officials (2 star and above) in keeping with reductions across the rest of the Department.

B. Managing by Outputs

5. Central to the new operating model is the clarity of the outputs each Command is expected to plan and deliver within an agreed budget which provides the framework for the Service Chiefs, as delegated budget holders, to be able – within a tight control framework – to flex within their budgets as long as they continue to deliver the outputs set out in the plan.

6. Despite the improvements that have been made in financial management, there remains a lack of a proper focus on outputs, not least in the planning and resource allocation process. The most stark example of this is in the handling of personnel costs (both civilian and military), where I heard many requests by Commands for greater flexibility, and which is at the heart of the challenges the Department is facing in properly applying a Whole Force approach to managing its ‘human capability’. This continued focus on inputs rather than outputs undermines the real benefits of the Operating Model and its over-arching principles of delegation, responsibility and accountability. It makes more difficult properly holding to account those areas which are not fully embracing the opportunities and responsibilities of the new operating model.

7. There are a number of causes for the difficulties in making the step change to a proper focus on outputs that is required; but the two most significant are:

- a. Departmental planning and resource allocation processes continue to focus on inputs, such as the numbers of military or civilian personnel, rather than being output based and allocating resources to deliver the high-level capability requirements for each Command and the processes or standards with which they must comply,

thereby allowing the Commands to submit their own proposals for the optimum balance of resources (including manpower) to deliver the defined outputs; and

- b. Historically the focus has been on Regular manpower numbers as a proxy for military capability, or a reduction in civil service numbers as a proxy for reducing bureaucracy. While these may have been useful in demonstrating a political intent to Defence, the traditional measurements of military power – particularly the number of troops – risks obscuring the reality of modern military power. We need to acknowledge the increased importance of cyber warfare, international collaboration, intelligence, surveillance and if necessary ‘fewer but better’ tanks, warships and attack aircraft. A new lexicon to better describe what the nation requires of Defence is required in the future.

8. In sum, having set the outputs to be delivered through the new Defence Strategic Planning Framework in SDSR15, the planning and resource allocation process needs to be more strategic and rooted in framing the resource (and any other) constraints for informed proposals by the Commands through their Command Plans of how the outputs should be delivered.