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Industry Best Practice and the Defence Business Space

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INTRODUCTION

1. In contrast to the ADF's requirement to prepare for a distant, largely conceptual battlespace, industry operates in a business space that is ever-present. The battlespace and business space share a number of similarities; both are risky, unpredictable, complex and competitive. Both require a dynamic combination of leadership skills and management acumen to deal with changing situations and opportunities. But whereas the battlespace is ultimately mastered by the threat or use of lethal force, business operates in an environment of less hierarchical relationships, generally fewer resources, more competitors and stringent regulatory requirements.

2. Over the years, business and management systems have borrowed heavily from each other. Business has appropriated strategic planning and organisational theory from military usage, while the military in turn has accepted civilian techniques such as total quality management (TQM), an explicit approach to risk management, as well as program management and budgeting (PMB). Today, as militaries the world over respond to the challenges of insurgencies and failed states by adopting flatter, integrated and adaptive frameworks, how does business respond to an operating environment characterised by globalisation, and enhanced shareholder expectations? In turn, can Defence learn anything from industry to improve its own business practices?

AIM

3. This paper will assess the 2007 Defence Management Review (DMR) in light of industry best practice in business systems as well as Defence's own progress with the decade-old Defence Reform Program.

INDUSTRY BEST PRACTICE

4. Australian companies operate under the Corporations Act 2001. Companies comprise a corporate entity, its shareholders, and its officers. The Act requires this last group to be divided into a Board of Directors and executive management (board and management). The board operates only as a group, and is led by a Chair. Management is responsible to the board, through a singular Chief Executive Officer. In turn, the board is responsible to the company's owners or shareholders.

5. The Australian Institute of Company Directors (AICD) proposes the Tricker's framework¹ as describing a 'best practice' method of operation of the board.

	Compliance roles	Performance roles
External role	Accountability	Strategy formulation
Internal role	Monitoring and supervision	Policy making
	Past and present	Future oriented

Table 1

6. The framework shows that boards have a dual role not only for compliance, but crucially for their companies' performance and direction. Boards should create enduring value, not be merely passive guardians of the firm's ethos and regulatory standards. This does mean that boards run companies – this is most definitely the role of the CEO and his/her team. But board and management must work together on formulating strategies and making policies. It is the responsibility of the board to set the strategic direction, the ethical 'tone at the top', and risk appetite – while management devises plans and systems to realise them. The board's other main role is to appoint the CEO, and undertake successor planning. In recent years, many companies have developed charters to set out the powers and duties delegated to management, and those reserved for the board.

7. Boards will appoint specialist committees to help them deal with the mass and complexity of management information and regulations. Common committees include audit and risk, nominations, remuneration, and governance and compliance. Again, care needs to be taken to ensure that committees do not confuse accountability, and ensure that they add value to the board's functioning.

8. Executive management can be organised in a number of ways. Under the leadership of the CEO, management can be arranged:

- a. By function, including sales and marketing, operations, technical services, business systems, research and development;
- b. By product line - each major product or product family would be generated by a separate organisation which would comprise of a 'slice' of the above functions;

¹ Robert I. Tricker, *International Corporate Governance: Text Readings and Cases*, New York: Prentice Hall, 1994, p. 149.

- c. By geographic region – each regional organisation would deliver all product lines and would also comprise of a slice of these functions.

9. The design choice for an organisation will depend on the nature of the business. Issues such as customer focus, a technical versus a consumer-style product, change drivers, competition and geographic spread will dictate this choice. In an increasingly competitive market, businesses will seek to position themselves as close to the customer as possible. This will entail a clear division of labour between a head office responsible for strategic direction, policy setting, business systems and governance, and regional offices responsible for operating existing business, winning new business, as well as managing local human resources and costs. It also requires that clear delegations, and lines of authority and accountability, are in place up and down the organisation in order to speed-up business response.

DEFENCE'S BUSINESS SPACE

10. In contrast, Defence's business space lacks the focus, definition and coherence of civilian industry. Concepts such as owners, shareholders, outputs, customers and suppliers are not easily read across into the Defence domain, despite numerous attempts at making Defence more 'business-like'. Although Nick Warner has asserted that 'we've begun the process of reform',² Defence has been in a state of change since the Tange Reforms of the 1970s.

1997's Defence Reform Program

11. Just 10 years ago, Defence embarked on its deepest reforms since Tange. It is instructive (and slightly poignant) to review the objectives that the Defence Reform Program (DRP) that started in 1997. They bear a striking resemblance to some of the industry trends described above. Under the DRP:

- *'Defence administration will increasingly focus on supporting the combat elements of the ADF. This involves a cultural change... towards a focus on Defence's key output...highly capable combat forces.*
- *The size of the Defence Headquarters will be cut, and the numbers of committees and senior ranking military and civilian positions reduced to speed up decision making and reinforce lines of responsibility and accountability.*

² Nick Warner, *Media Release - 256,800 Paper Hand Towels: Mending Defence's Broken Backbone*, Speech to the Lowy Institute of International Policy, 10 Jun 2008, available at: <http://www.defence.gov.au/media/speechtpl.cfm?CurrentId=7831>, accessed 14 Sep 08.

- *Recognising the fundamental importance of the Chiefs of Navy, Army and Air Force, the Service Chiefs will have greater responsibility in overall Defence policy development....*
- *Command responsibilities will be made clearer, with operational headquarters amalgamated.*
- *An integrated joint Defence Headquarters developing policy and providing advice to all Defence senior managers.*
- *Acquisition functions will be collocated and reorganised into groups focusing on common industry sectors or equipment types ...rather than divided by Service.*
- *Support and administrative functions will be consolidated and duplication cut to maximise efficiency....*³

12. As the DRP progressed, it identified 'output executives' and 'enabling executives' in a further attempt to recast itself according to a 'purchaser - provider' model common in civilian industry. As output executives, Army, Navy and Air Force would be funded to purchase the services of a reorganised and consolidated Defence Materiel Organisation (DMO) and Corporate Services and Infrastructure Group (CSIG).⁴ DMO and CSIG '...will have no internal revenue allocated to them They will rely on the price they are paid by the output executives'.⁵ Two further measures are noteworthy. 'Owner executives' would discharge Defence's responsibilities to government and through it the Australian public. Also Defence would retain the diarchy, with the Secretary and CDF jointly heading the Department.

How the DRP Fared

13. Over the next 10 years substantial progress would be made on a number of these initiatives. Combat capabilities benefitted immensely from the demand imposed by the ADF's operational tempo experienced since INTERFET. This operations focus has also resulted in the integration of the functional commands into HQ Joint Operations Command, and the associated reorganisation of Defence HQ in Canberra. Defence Materiel Organisation was established to streamline and improve equipment acquisition and sustainment.

³ Ian McLachlan, *Media Release – Minister Announces Defence Reform Program*, Office of the Minister of Defence, 11 Apr 97, <http://www.defence.gov.au/minister/der/m97061.htm> , accessed 14 Sep 08

⁴ CSIG is now the Defence Support Group (DSG).

⁵ Peter Reith, *Speech: Defence Reform: The Big Picture Australian Business Limited Breakfast – Canberra*, Office of the Minister of Defence, 7 Jun 01, available at: <<http://www.minister.defence.gov.au/ReithSpechtpl.cfm?CurrentId=732>>, accessed 14 Sep 08.

14. Progress on other fronts has been less impressive however. In time Defence HQ would grow dramatically, to the extent that it could not fit within the purpose-built Russell Redevelopment. The role of the Service Chiefs in capability management has been compromised through a lack of control over the various inputs they need; force structure, recruiting, equipment, facilities, corporate services and information communications technology (ICT) must be accessed through still-developing arrangements with other Defence groups. There is also growing realisation that the DRP cut too deep across the portfolio in its quest for efficiencies. In addressing some of these shortfalls, Defence's response has been to create additional 3 star billets, with associated staff, while retaining a diffuse and confusing committee system.

The Defence Management Review

15. As a result of these perceived failings, the Howard government, nearing the end of its electoral cycle, compelled Defence to again review its business activities. Government was mindful of the ADF's intense operational tempo and Defence's comparative wealth, but was also concerned that the Department had lost its focus on efficiency and was displaying weak financial and resource management acumen. Businesswoman Elizabeth Proust reported her findings in April 2007.

16. Defence accepted all but one of Proust's 53 recommendations,⁶ which were framed across the domains of Accountability and Service Delivery, Organisational Design and Governance, People, Financial Reform, and Information Management. Rather than revisiting the breadth of the DRP, or the subsequent Kinnaird Review of Defence Procurement, the DMR confined itself to those structures, practices and inventory that were clearly in need of fixing - Nick Warner's 'Defence's broken backbone'.

17. At the time, Paul Dibb observed that 'many of the...recommendations of the Review make sense, even if they are far too detailed.'⁷ Some of the more germane recommendations included:

- *R6: The Secretary and CDF set a joint vision and strategic direction for Defence and ensure adherence...and confront the consequences when adherence does not occur.*

⁶ Defence did not agree with Proust's recommendation to define more clearly the roles of the CDF and Secretary.

⁷ Paul Dibb, *Independent Management Review Critical of Defence*, Australian National University, Apr 07, available at: <http://rspas.anu.edu.au/papers/sdsc/analysis/IndependentManagementReviewCriticalofDefence.pdf>, accessed 14 Sep 08.

- *R7: Defence governance structures, including Charters, be designed so as to facilitate real accountability by senior executives. Charters should provide more explicit guidance on the executives' responsibilities within the Defence service delivery model*
- *R8: Defence leadership commit to a high-level business model which clearly defines roles and responsibilities, and distinguishes policy and core business from service delivery.*

18. Defence had clearly failed to construct the DRP's lines of responsibility and accountability in 10 years. The DMR did not explore the reasons for this failure. It does mention a service delivery model certainly, but relies on prescriptive charters and service level agreements to ensure compliance. Proust and her team might have considered the adage that 'cash is king' and invest customers with the funds to purchase services on terms and conditions from suppliers.

19. But in designing the organisation, Proust recommends that Defence:

- *R16: Apply the following guiding principles for the organisational design: The organisation must be able to maintain a high operational tempo while providing sufficient capacity for longer-term issues...The structure must facilitate the considered strategic leadership of the organisation. The design must make sense to the organisation, be understood and easily communicated.*

20. The DRP's emphasis on customer-supplier relationships is clearly no longer a design principle. Nor is a defined split between policy and implementation, nor the sensible delegation of responsibility downwards from Defence Headquarters, to the Services, to their functional commands, and Defence regional presence. The conclusion can reasonably be drawn that the Proust Review had been written with a Russell Hill audience in mind. The subsequently derived Defence Business Model (DBM) compounds these failings:

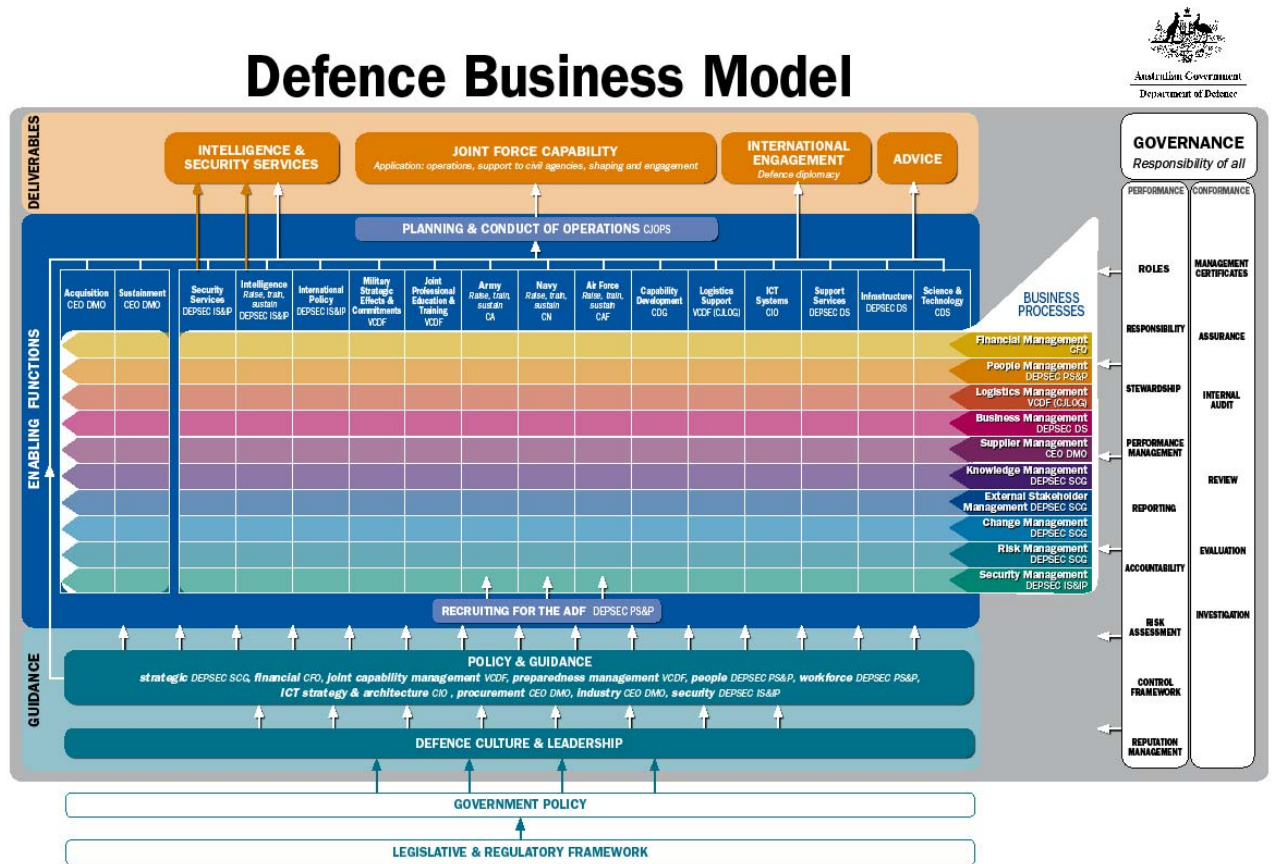


Figure 1

21. The model contains no less 16 enabling functions, supported by 10 business processes, 10 policy and guidance measures, plus a four-element governance framework that together build to four 'deliverables'. The primary role of the single services in generating capability, supported by the other agencies, is hard to discern. All enabling activities seem to contribute to the planning and conduct of operations – at the expense of building future capability. It appears to prop up existing fiefdoms, including 'Recruiting' and 'International Engagement, and needlessly caters for fetishes like 'Advice to Government'. The last section of this paper makes recommendations for the DBM's improvement.

22. In regards to Defence's unwieldy committee structure, Defence should:

- *R19: Establish a new top executive committee (the 'Defence Strategic Management Advisory Council') to replace the DC and COSC with a more streamlined membership and strategic focus supported by subcommittees including audit, personnel, OH&S, risk and possibly other committees.*

23. This measure would align Defence firmly with industry best practice. It would relieve the principals of many onerous responsibilities through

delegation, allowing them to concentrate on purely strategic matters. But at the single service level, Defence should:

- *R22: Formally recognise within Defence the roles of the Service Chiefs for the leadership, management and development of military personnel of their Service...*

24. Ironically, this is the only place in the report where the role of the Service Chiefs is mentioned. The Proust Review steers clear of weightier matters associated with capability and its acquisition, treating the single services as one of numerous inputs to capability.

CONCLUSION

25. Industry best practice in business systems has seen a separation, but close relationship, between boards and management. This relationship ensures that the board remains apprised of both performance and compliance, while delegating the running of the company to management. Defence has attempted to integrate these kinds of practices into its own business space over the last 30 years, with varying levels of success. Defence is a large and very complex organisation and the challenges in doing so should not be underestimated. Despite having arguably cut too deeply, the DRP remains valid today due to its underlying principles. The recent DMR has not replaced them, but has merely gone after low-hanging fruit that needed to be picked. The resultant DBM is a hyper-matrix, confusing, process-driven and Canberra-centric, and could very usefully be revisited to reflect the policy and implementation components of Defence.

RECOMMENDATIONS

26. It is recommended that Defence:
- a. Renew its efforts to develop a viable 'customer-supplier' service delivery model in order to benefit from its compelling financial management discipline;
 - b. Acknowledge and restate the services' pre-eminent role in force generation and capability management;
 - c. Disestablish the DC and COSC IAW R19 and replace them with a Board approach supported by appropriate subcommittees;
 - d. Revise the DBM in order to satisfy R16's test of comprehension, including:

- (1) 'Deliverables' be renamed 'Defence Outputs';
- (2) 'Enabling Functions' be renamed 'Outputs', and further divided into 'Capability Outputs' and 'Enabling Outputs';
- (3) 'Recruiting for the ADF' be treated as simply one of the Enabling Outputs;
- (4) 'Capability development' to accompany 'Planning and conduct of operations' as the two *prima inter pares* outputs;
- (5) Business Processes, Governance, and Policy and Guidance be combined into the one function, and therefore simplified.
