

**MORE TOOTH, LESS TAIL****by John Dowdy**

*John Dowdy is Director of McKinsey & Company based in London. Here he argues the case for maintaining the spend on equipment procurement by cutting elsewhere.*

Defence Ministries everywhere, faced with spiralling national deficits, or demanding military commitments in theatres like Afghanistan, and often both, are braced for deep cutbacks over the next months and years. Right now, with the general election behind us and the strategic defence and security review under way, the spotlight is firmly on the UK.

**Cutting or Slowing Equipment**

The temptation to cut or slow down major equipment programmes is understandable. Last year's review of UK equipment acquisition by former Ministry of Defence adviser Bernard Gray described overspending as "endemic" and the equipment programme as "unaffordable". The National Audit Office has itself concluded that, if fully implemented, the programme will cost £15Bn more over the next 10 years than has been budgeted.

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Over the past 12 months, various pundits have suggested cancelling the third tranche of Eurofighters, or the A400M transport aircraft, and, for a while at least, the new class of nuclear missile submarine. The £5.2Bn project to build two new aircraft carriers is another popular target. Decisions to scrap contracts to build new aircraft carriers or buy additional fighter aircraft, or to reduce numbers of submarines might well seem politically expedient, as they would appear to save conveniently big numbers at the stroke of a pen.

In the strange world of defence economics, however, these cuts don't always translate into nearly the magnitude of savings that are anticipated. Contractual break clauses and the advance purchase of long lead items dog efforts to cancel 'unaffordable' programmes. Reductions in platform numbers often drive the unit cost of the remaining items skyward. Cutting one in four new submarines, for example, will produce rather less in the way of savings than the implied 25% reduction.

But make no mistake, cutting the equipment programme is a cut in defence capability – reductions in the fighting power of the nation, of the tooth, not the tail. Absent comparable reductions in the size and cost of the tail, the efficiency and effectiveness with which defence inputs are translated into defence outputs goes down, not up.

To the extent that Britain is reviewing its role in the world, dramatic gestures may be fully justified. If parts of the country's fighting capability are no longer necessary to sustain its strategic role in the 21<sup>st</sup> century, they should obviously go. What the new UK Government should not do – and does not need to do – is to use cuts in equipment expenditure alone to balance the defence budget.

**International Comparisons**

McKinsey & Co's recent study of international defence efficiency – covering 33 countries – highlights the issue. Our benchmarking exercise for the first time compares the performance of different national Ministries, pinpoints the main areas of poor productivity, and in the case of the UK concludes that significant savings are achievable both in equipment maintenance and administration. Addressing these will allow a greater proportion of the defence budget, not less, to be spent on equipment.

Comparing the armed forces of different countries is challenging, not to say controversial. Many commentators argue that national priorities, political contexts and military strategies are too different to make the exercise meaningful. Some countries consciously support their defence industries, and others buy more cheaply on the world market. Some, like the US, maintain worldwide strike capabilities; some are mainly static defensive forces; while others face little or no security threat as neutral or non-aligned nations.

Defence departments everywhere, however, engage in the same types of *operational* activity and how they perform in this respect is instructive. International benchmarks, moreover, offer the best hope for evaluating whether public spending in defence provides real value-for-money.

Individuals applying for a passport or undergoing an operation in a state-funded hospital at least have the chance to make some sort of informed judgement themselves about the effectiveness of the responsible Ministry. There is no such opportunity, except in times of war, for the ordinary citizen to test the efficiency and effectiveness of the country's armed forces. By then, the cost of failure is dramatic.

At present, the proportion of the UK's total defence budget spent on equipping its combat troops is just under one-fifth of total spending, whereas the US has been spending up to one-third of total expenditure on the so-called investment accounts – procurement of military equipment and associated research, development, test and evaluation.

A case can therefore be made that we should be spending a higher proportion of whatever budget the MoD has available on the tooth, at the expense of the tail.

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**Cutting Equipment Support**

The UK spends roughly 13% of its defence budget on equipment support. When this is translated into the cost per unit of fighting power (the cost to support an infantry battalion, or an aircraft squadron, or a frigate) the UK falls toward the high end of the range, above most of the countries with comparable strategic postures, and higher than the US.

This is driven by a number of factors. First, of course, is the high level of wear and tear resulting from the high operational tempo. The conditions in Afghanistan are tough on equipment.

The second factor is readiness. Some countries have chosen to reduce total defence expenditure by deferring maintenance activities, but this has a very real cost in terms of readiness levels.

The country's ageing equipment fleet – comprising a range of different types of vehicles, helicopters and aircraft – is another reason for the relatively high spending in this area. As any owner of a vintage car understands, armed forces that continue to operate older equipment generally incur higher maintenance costs. That is one reason why decisions to 'save' money by deferring acquisition programmes are not what they seem. What's forgotten are the additional, and increasing, costs of continuing to support the older equipment over a longer period before the new supplies finally arrive.

Our benchmarking further highlights opportunities to improve maintenance process efficiency – the ability to maintain and operate a given piece of equipment, of a given age, at a particular scale, at the right level of readiness. In our work with defence ministries around the world, we have found wide variability between maintenance, repair and overhaul (MRO) functions when it comes to these maintenance processes, the use of outsourcing, and the quality of contracting skills. The UK is world-class in some respects, but by no means in all.

**Cutting Administration**

The second area in which big UK savings can be made is administration. McKinsey's benchmark study shows that this item accounts for around 20% of the UK's total activity, against 11% for the 'peer group' of countries with a comparable strategic outlook.

Much of that spending, of course, yields real benefits. It includes so-called soft power – for example a defence attaché here, a representative in Brussels there – a key component of the country's wider diplomatic armoury. The magnitude of the gaps between the relative costs of administration in other comparable countries and the UK, however, suggests that there is a significant opportunity for the MoD to get more bang for its buck.

Other countries have already shown the way. One Northern European nation consciously set out several years ago to increase its 'tooth to tail' ratio (combat and combat support as a percentage of total defence expenditure) from two-in-five to three-in-five. The project is not yet complete, but it has shown how much can be achieved through the centralisation and streamlining of formerly duplicative functions like HR, IT, finance, health services and facilities management.

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**Improving Productivity**

It would be naive to underestimate the difficulty ahead for the UK to extract savings sufficient to free up resources for better equipment and more front-line fighting capability. Huge efforts will be required to get 'buy in' from defence leaders and to promote collaboration as an alternative to conflict between different branches of the armed services. But Ministers should use the current financial crisis to garner the necessary support for change.

The worst outcome would be to unnecessarily deplete UK capabilities without achieving the immediate objective of reducing costs. Far better will be to embark on far-reaching productivity programmes that enable the UK to deliver more defence output for less. Governments have a poor record of improving public sector productivity. However, the existence of benchmarks and better practices in other countries can serve to reinforce their determination. They show that change really is possible. ■