



National Audit Office

**REPORT BY THE  
COMPTROLLER AND  
AUDITOR GENERAL**

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**Ministry of Defence**

Managing change in the  
Defence workforce

## Key facts

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**£4.1bn**

gross savings from reducing headcount by 2015 estimated by the Department

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**£0.9bn**

total costs of redundancy and early release schemes estimated by the Department

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<b>£38 billion</b>	funding gap identified in the ten-year Defence Budget announced in Summer 2010
<b>£4.3 billion</b>	overall savings from non-front line activities that the Department aims to make from taking measures outlined in the Strategic Defence and Security Review
<b>£2.7 billion, 7.5 per cent</b>	reduction in the Department's annual funding in real terms by 2014-15
<b>£4.1 billion</b>	savings the Department expects to make to its overall budget over four years through reducing headcount (excluding the three month exercise)
<b>29,000 (34 per cent)</b>	reduction in civilian personnel by 2015
<b>25,000 (14 per cent)</b>	reduction in military personnel by 2015

# Summary

## Background

**1** The Ministry of Defence (the Department) faces significant financial problems in balancing its budget. In 2010, it announced that it had a funding gap of £38 billion over the next 10 years. In addition, the 2010 Spending Review required the Department to make spending cuts of some 7.5 per cent in real terms (£2.7 billion) by 2014-15 as part of efforts to reduce the deficit across all government departments.

**2** In October 2010, the Strategic Defence and Security Review set out measures for the Department to balance its budget, which included cutting non-front line costs by an estimated £4.3 billion by 2015. The Defence budget has a relatively high level of fixed costs in the short term and a significant amount of procurement and equipment expenditure is committed for years in advance. The consequence is that the Department has relatively little flexibility to reduce spending in some areas of its budget.

**3** Personnel costs comprise over one-third of the budget and are more flexible in the medium and long term. As a result, a large part of the savings the Department needs to make under the Strategic Defence and Security Review will come from reducing headcount. The Review announced that the Department would cut its civilian workforce by around 25,000; and the military by around 17,000. In spring 2011, the Department conducted a subsequent exercise to identify further cost savings, known as the three month exercise. This exercise reduced the workforce further, the revised total reductions are: 29,000 in the civilian workforce (34 per cent) to 57,000 personnel and 25,000 (14 per cent) in the military, namely through further reductions in the Army, by 2015, to 152,000 personnel: a total of 54,000 headcount reductions.

**4** The Department estimates that reducing headcount will cut its costs by £4.1 billion between 2011-12 and 2014-15. This is based on the reductions set out in the Strategic Defence and Security Review and does not include the additional reductions in headcount required by the three month exercise which the Department has not yet finalised. The Department has not yet published any revisions to the amount it expects to save from the Strategic Defence and Security Review overall.

**5** To meet its headcount reduction targets, the Department has started a redundancy programme and a Voluntary Early Release Scheme, both of which run in several tranches. These aim to reduce the Defence workforce by around 23,000 civilian and military personnel. At least 16,000 (30 per cent of the total reductions required) will leave through natural wastage and approximately 1,700 personnel transferred to the private sector. These figures are likely to change depending on levels of natural wastage and changes in planning. Defence Trading Funds are expected to reduce headcount by

4,400, however, as they are undertaking this work separately from the Department we have not included their actions in this report. The Department has not yet determined in detail how it will reduce the Army headcount further by the 5,000 required by the three month exercise but expects it will be through a mixture of redundancies and natural wastage. The Department has not reduced its headcount on this scale since the 1990's 'Options for Change'.

**6** A number of cost savings were announced in the Strategic Defence and Security Review such as the early removal from service of some 'force elements' of the Armed Forces, such as the Harrier fleet. The numbers of military personnel associated with these 'force elements' are relatively clear and the Department understands the consequences of the reduction. The relationship between personnel numbers and the Department's other activities is less clear. The Department needs to determine how it will transform the way it works in order to deliver Defence's strategic objectives as its personnel decreases.

**7** The Department is developing a new operating model which will set out how Defence will work in order to meet its purpose of defending the United Kingdom and its Overseas Territories, citizens and interests and helping to strengthen international peace and security. By changing the way Defence operates, the Department is seeking to ensure it can continue to meet its objectives with fewer people. The high level structure of this model has now been determined and the Department is now working on the detail that will be needed to implement these new ways of working. The Department currently has a portfolio of some 47 initiatives to transform various elements of its business.

**8** The Department has had little choice other than to make cost cuts early if it is to meet spending review targets. Consequently, it has commenced reducing its headcount before the full detail of the new operating model has been determined. Recognising the risk inherent in this approach, the Department has taken steps to retain skills in line with the requirements of the new model as much as it can predict and is feasible. There remains a risk, however, that some of the skills it needs now and in the future may be lost.

**9** This report examines how effectively the Department is managing workforce changes without impacting negatively on the delivery of its strategic objectives given the speed of the reductions. It builds on earlier National Audit Office work that reported on how government departments are making cost reductions, while focusing on workforce change. This report will also consider some of the steps the Department has taken to limit the loss of some specific skills. Our study methods, undertaken in the second half of 2011, are outlined in Appendix One.

## Key findings

### Planning for headcount reduction

**10 Our review has concluded that the Department has followed good practice in planning its headcount reduction to date.** The Department has provided consistent central direction, allowing the detailed planning for military and civilians to evolve separately to consider different terms of employment. The first tranches of the military redundancy programme and civilian Voluntary Early Release Scheme have progressed without problems to date.

**11 The Department has developed good models and tools that have helped it to profile the numbers of headcount cuts required, and the predicted savings.** The assumptions underpinning these models need adjusting to reflect the actual cuts being made. This is not unexpected given the scale and complexity of the redundancy programme and Voluntary Early Release Scheme and the difficulty of predicting who will apply to leave.

**12 The Department has mixed information on its workforce.** Good workforce information is essential for departments to make sensible decisions about which skills, in what quantity, and where, they must retain to deliver their strategic objectives effectively. The Department recognises this and, in response to previous shortfalls in data quality, is now generating better information on the numbers of civilian personnel. It already has good information for its military personnel.

**13 The Department's information on civilian skills needs improving.** While the Department has good information on the skills of its military workforce, its information about the skills of the civilian workforce is limited. The Department has recognised this might lead to the risk of it inadvertently losing skilled personnel. To address this risk, data on civilian skills is being gathered from applications to the Voluntary Early Release Scheme. This approach will however, only provide data in respect of an individual applicant's skills and not the entire civilian workforce, and then, only once the scheme is under way. Consequently, the Department will struggle to target its headcount reductions on the skills it most needs to keep.

### Obstacles to successful delivery

**14 The Department faces a number of obstacles to reducing headcount while delivering Defence objectives.** These include the scale of change that the Department is undergoing and the possibility that the financial savings needed may not be realised.

### Scale of change

**15 The Department is undergoing a period of significant change alongside making headcount reductions.** It has a portfolio of some 47 change programmes and initiatives for which oversight and reporting arrangements are in place.

**16 The Department will need to profoundly change how it works to ensure it can deliver its strategic objectives with fewer staff.** It has struggled to do this in the past with previous initiatives to reduce headcount such as PACE and Streamlining which did not change ways of working although they did successfully reduce headcount. We acknowledge progress is being made to change ways of working in the Defence estate and corporate services; and other initiatives, such as those at the Defence Equipment and Support organisation, seem to be heading in the right direction. We have not, so far, seen enough detail to determine whether in aggregate the overall programme of change initiatives will really transform how the Department works. Without real changes to ways of working, cutting headcount is likely to result in the Department either doing less with fewer people or trying to do the same with greater risk.

### Making financial savings

**17 The Department has not identified further potential savings measures should the headcount reduction not deliver the required financial savings.** Instead it is relying on some financial contingency and the tranche structure of the redundancy programme to give it flexibility. As planned savings are sensitive to several factors including delays to the redundancy programme, this approach may not be sufficient. For example, the second military tranche has been delayed by three months to allow for broader changes in the Department. The delay has reduced savings from this tranche alone by an estimated £100 million to £138 million to 2015; 4 to 5 per cent of total savings projected to be made in the military headcount reduction.

**18 The Department has not yet developed detailed plans on how it will reduce the Army headcount further.** The Department has to reduce the numbers in the Army by a further 5,000 as a result of the three month exercise to cut costs. The Department has started to redesign the structure of the Army around this new figure. It has not yet profiled the numbers of people that will go through natural wastage or through redundancy. Any delays to the process would erode the point at which the resultant savings exceed the cost as the Department continues to pay salaries, benefits and contributions to pensions.

## Skills gaps

**19 The significant reduction in headcount creates a risk that current skills gaps will worsen.** There is a significant risk that current skills shortages will worsen particularly as at least 16,000 personnel, 30 per cent of the reduction required, is predicted to occur through natural wastage, a process over which the Department has less control than redundancy. A loss of skills is of less concern for the first military redundancy tranche which has excluded key skills and targeted surplus trades. The Department also takes into account skills when assessing civilian applicants for Voluntary Early Release and has stipulated a small number of specific skills that cannot be released under the Scheme.

**20 Despite these efforts, skills gaps may become more acute in future because headcount reductions will be well under way by 2013, with the Royal Navy and RAF redundancies substantially complete.** This will be before the detail of the new operating model and the mix of skills required, have been determined. Furthermore, the Department has not yet stipulated the numbers of personnel who will leave individual business areas. These factors make it very problematic for the Department to target headcount reductions to areas deemed less critical although the latter gives the Department some flexibility to target areas as the operating model develops.

**21 The Department will struggle to maintain skills through recruitment.** The Department has learned from previous headcount reduction programmes and has continued to recruit military personnel, although at much lower levels. The Department is constrained on the civilian side by a government-wide civil service recruitment freeze albeit with some exceptions, for example, business critical posts.

## Conclusion on value for money

**22** The urgent need for the Ministry of Defence to reduce its costs has left it with little choice but to make rapid reductions to its workforce. The Department has acted decisively to put in place a redundancy programme and is making progress in planning for the future. So far, the redundancy programme is running well and the Department's approach has been largely in accordance with good practice. On that basis, we conclude that to date the Department has acted in a way that is consistent with value for money.

**23** For the Department to ensure that it can deliver its strategic objectives with fewer staff in the future, it will need to make far reaching changes to the ways in which it carries out its business. Developing the detail of the changes and implementing a new operating model for Defence will take time and is only likely to be complete after substantial numbers of skilled personnel have left. The Department needs to find a way to put in place a more targeted approach to achieve its intended outcomes to restructure its workforce as required and have the key skills it requires. Unless it does so, there are clear risks to its ability to make the necessary savings and still be able to deliver value for money in the future.

## Recommendations

**24** We make the following recommendations:

- a** The Department is in the difficult position of needing to cut its headcount quickly, to maximise financial savings. While it has taken some steps to retain some specific skills, it risks not having all skills that may be needed in the future. The full detail of the operating model will not be available until after the redundancy programme is well under way.

The Department should press on with developing and implementing the detailed operating model as a matter of priority and ensure that it aligns headcount reductions with the model as it develops.

- b** To ensure that Defence can deliver its strategic objectives with fewer personnel, the Department will need to transform how it works. We have not seen enough detail to determine whether the Department is making sufficiently substantial changes to the ways in which it works.

Greater emphasis is required on transforming ways of working to make sure strategic objectives can still be delivered with a reduced workforce.

- c** The Department currently has skills gaps in both its military and civilian workforce and estimates at least one-third of headcount reductions required will be made through natural wastage – a process over which it has less control.

The Department needs to maintain its vigilance over the emergence of new and worsening skills gaps in the medium to long term in its civilian and military workforce.

- d** The Department does not have good information on the skills of its civilian workforce.

It needs to step up its efforts to develop a comprehensive understanding of skills across its civilian workforce.

- e** Our experience shows that cost reduction programmes often deliver less than anticipated. While the Department has represented to us that it has set aside some financial contingency, it has not identified further potential savings measures in the event that current plans do not meet targets.

We raised the recommendation with the Department that it should develop a costed plan identifying how further savings would be made if they are needed. The Department believes it has the capacity to deal with any underachievement of its current plans through compensating adjustments in its budgeting process and that a costed plan is, therefore, unnecessary. Should this prove not to be the case we encourage the Department to revisit this recommendation in the future.