

# Franchise Funds in the Federal Government: Ending the Monopoly in Service Provision

New Ways to Manage Series



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The PricewaterhouseCoopers Endowment for  
**The Business of Government**

## F O R E W O R D

February 2002

On behalf of The PricewaterhouseCoopers Endowment for The Business of Government, we are pleased to present this report by John J. Callahan, "Franchise Funds in the Federal Government: Ending the Monopoly in Service Provision."

The question "Why can't government act more like business?" is frequently asked. In this report, John Callahan examines government franchise funds that were created to function much like private sector businesses when delivering administrative services within government. Callahan writes, "... they were expected to observe uniform rules of prudent and transparent financial management. They were expected to undergo independent, annual financial audits. They were to have full cost accounting and full cost recovery for their business operations." Callahan finds that franchise funds are performing as expected and fulfilling most of the operating business principles set forth for them. He recommends that Congress permanently authorize the franchise fund concept and that the concept be expanded to other agencies throughout government.

This report comes at an opportune time. In Congress, legislation dealing with franchise funds is now before the House of Representatives. In the executive branch, competitive sourcing is a major component of the President's Management Agenda. Because of its emphasis on cost accounting, users of common administrative services within the federal government can compare costs and quality. They can now choose between franchise funds, other government service providers, and the private sector. If expanded, franchise funds could be a key tool in government's "competitive sourcing" arsenal.

We trust that this report will be useful to key government officials in Congress, the General Accounting Office, the Office of Management and Budget, and executive agencies as they continue to examine the future of franchise funds in government. If government wants to act more like a business by eliminating internal monopolies in the delivery of common administrative services, franchise funds appear to be an important vehicle to encourage such behavior.

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## EXECUTIVE SUMMARY

The National Performance Review (NPR) in 1993 developed the concept of franchise funds. These funds were designed to break up internal governmental monopolies and encourage competition for and reduce the cost of providing common administrative services in the federal government. Legislation authorizing the creation of up to six pilot franchise funds was passed as part of the Government Management Reform Act (GMRA) in 1994.

Pursuant to operating principles promulgated and endorsed by the Chief Financial Officers Council (CFOC) and the Office of Management and Budget (OMB), franchise funds were intended to provide common administrative support services on a voluntary basis to governmental customers across a wide number of governmental departments and independent agencies. Franchise funds were expected to provide these services on a fully reimbursable basis, with no subsidies from appropriated funds, and were expected to recover the full cost of providing these services from their customers. They were to be fully voluntary in nature, meaning that customers could enter into and exit from service agreements with franchise funds as they saw fit. Customers could not be mandated to receive their services from franchise funds.

Franchise funds are governed by sound financial management practices. They are required to have an annual financial audit and are expected to receive an unqualified opinion on their audit. Funds that cannot fully recover their total costs of service are expected to drop their service lines or

in extreme cases go out of business altogether. These instrumentalities are to conduct customer satisfaction surveys and to develop performance measures for the provision of their services.

Six pilot franchise funds in different federal departments were subsequently created. This report provides both an overview of the structural and operational characteristics of these franchise funds as well as a more detailed analysis of the franchise funds in operation at the Department of Health and Human Services and the Department of the Treasury. Public documents concerning the operations of these two franchise funds, as well as in-depth interviews of senior officials responsible for the oversight and operation of these funds, were utilized by the author for this report.

The report also sets out various criteria by which one can evaluate whether these franchise funds have successfully achieved their service mission and ends with a set of recommendations for the Congress, the executive branch, the General Accounting Office, and the Office of Management and Budget about the legislative and administrative future of the franchise fund concept.

The report concludes that franchise funds have been a successful experiment in the business of government. They have seen considerable customer and service growth during their operation. They have expanded, modified, and even curtailed their service offerings as determined by the markets that they serve. They have operated on a self-sustaining basis and have practiced full cost recovery for their

services. While not all franchise funds have undergone an annual financial audit and while some have not developed detailed or sophisticated performance measures, they have been highly responsive to customer needs, opened up the doors to a wide variety of private sector subcontractors, and fared well in the competitive process of providing various administrative services to government customers. To that end, franchise funds should become a permanent part of the administrative service provider network at the federal level.



# Introduction

The franchise concept has a long legal and economic history. In England, franchises were royal grants by the king to his subjects. In our own legal tradition, *Black's Law Dictionary* notes that a franchise "... is a privilege or immunity of a public nature which cannot be legally exercised without legislative grant."<sup>1</sup>

In economic parlance, franchising is defined as "a contractual arrangement under which an independent franchise produces or sells a product under the brand name of the franchisee and to his specifications and with marketing and other support."<sup>2</sup>

The six governmental franchise funds authorized by the Government Management Reform Act (GMRA) of 1994 are grounded in the legal and economic traditions of the franchise concept. They are specifically authorized to operate by federal law; they are granted certain powers and rights not accorded to other fee-for-service instrumentalities; and their day-to-day operations are similar to private sector franchise operations. They offer services according to the dictates of their sponsoring agents—their governmental service customers. They provide services on a voluntary basis, and are expected to operate within the federal financial management landscape designed to maintain the fiscal integrity of their operations. Their overall legal and operating construct is not dissimilar to that of private franchise operations.

While this analogy to the private sector is not perfect, these governmental franchise funds operate as entrepreneurs in the public service arena. They "sail on their own bottoms," as it were and succeed

or fail, in great part, on the price, quality, and responsiveness of their service offerings.

Thus, we should determine whether franchise funds in the federal government are achieving the objectives envisioned by the National Performance Review (NPR), whether they should be expanded, or whether they should be regarded as just an isolated bureaucratic experiment designed to provide a limited set of services on a highly selective basis.

This report analyzes the origin and legislative background of the GMRA franchise fund pilots authorized in 1994. It provides a summary description of these franchise funds and examines in detail two such funds now operating at the Department of Health and Human Services (HHS) and the Department of the Treasury. The latter part of the report sets forth several criteria for evaluating the success or failure of these two franchise funds and ends with a set of recommendations that should be borne in mind as the Congress and the White House consider whether these funds should be permanently authorized or expanded.

The lessons learned from this report should inform executive and legislative branch decision makers as they consider ways to increase government efficiency and effectiveness in the provision of services without diminishing the public mission behind the provision of governmental services by these franchise funds. Indeed, the question may not always be an either/or proposition of whether a service will be provided entirely by a public bureaucracy, partly by private contractors, or be totally privatized. Rather, the question may be more appropriately whether

the service to be provided can have a transparent cost and pricing structure and whether the service can be provided with high quality levels that will meet the needs of the paying customer.

The franchise fund initiative analyzed in this report should answer a number of questions about the viability of these instrumentalities and whether they should be continued, terminated, or expanded as a means of promoting greater efficiency and cost-effectiveness in the delivery of a number of public services.

# Franchise Funds: Legislative Origins

Franchise funds trace their legislative origin to the Government Management Reform Act of 1994, but derived their basic impetus from the early efforts of the National Performance Review. Among its many initiatives, NPR also sought to promote a more entrepreneurial approach to the provision of selected governmental services.

As part of an overall program to reinvent government, the NPR wisely sought to devote more attention to eliminating service monopolies in common administrative services and to providing such services on a competitive basis similar to that in the private sector. As a 1994 NPR report on the subject of franchises noted: "Like the concept in private industry, franchise organizations must meet customer needs in order to be financially self-sustaining. If the franchise organization cannot compete in the environment in which it operates, it will eventually cease to exist."<sup>3</sup>

The rationale could not be clearer. Government service monopolies were to be a thing of the past. New cross-servicing organizations were to be created that would provide for a more competitive playing field for the provision of administrative services. Duplicative services would be eliminated, economies of scale would be realized, the unit cost of administrative services would be reduced over time, and services would be provided on a voluntary basis.

A further impetus for this concept came from the realization that entrepreneurial organizations already existed at the federal level. The 1994 NPR report noted that as of that time there were over 100 entre-

preneurial organizations operating throughout the government, the most significant being the 49 Cooperative Administrative Support Units (CASUs) that were prevalent in federal regions.<sup>4</sup>

Again, another positive message came from the NPR. Franchise funds were not only desirable from a "better business" point of view, but also the federal government had enough practical experiences with the entrepreneurial dimensions of the concept due to the long-standing nature of CASUs and other financial instrumentalities like working capital funds. Franchise funds were not being invented from scratch. Rather, they were to be a more expansive and refined application of existing mechanisms that emphasized more fully the concept of entrepreneurial government.

Having promoted the concept, NPR staff at the working and senior levels sought a legislative foundation for these mechanisms, ultimately resulting in the passage of the Government Management Reform Act of 1994 (P.L. 103-356).

The House action on a broad government reform measure, H.R. 3400, was nearly unanimous; it passed by a vote of 429-1 on November 22, 1993. The Senate was unable to pass the omnibus bill, containing more than 50 NPR-inspired reforms including franchise funds, that passed the House. One of the obstacles to passage was that opposition developed around the number of franchise funds to be authorized by the bill and the fact that such franchise funds would face far less regular fiscal scrutiny of their operations by congressional appropriations and OMB staff.

The Senate Governmental Affairs Committee subsequently reported a bill that comprised selected provisions of the House measure as S.2170 almost a year later and then passed it on September 28, 1994. The House then passed this measure, and it was signed into law on October 13, 1994 as the Government Management Reform Act of 1994.<sup>5</sup>

The genesis of franchise funds then derived from two basic sources. First, they were the more entrepreneurial successors of service and financing mechanisms that already existed in various agencies, most of which had no explicit legislative construct. Second, they were the brainchild of NPR staff, who felt that they should have a legislative construct, be put in place throughout government, and be more cross-servicing and voluntary in nature than their predecessors so that a full-scale competitive process could be injected into the provision of selected governmental services. OMB and the Chief Financial Officers Council (CFOC) developed a series of business principles to serve as operational guidelines for franchise funds.

OMB prepared two reports on the performance of franchise funds with the active participation of the CFOC in the first several years of the pilots' existence.<sup>6</sup>

These two reports provided generally favorable assessments of the franchising concept, but acknowledged that individual pilot franchise operations warranted improvements in various areas.

The first report was prepared pursuant to a requirement in GMRA to report to the Congress on the performance of the franchise pilots. The report recommended extension of the franchise fund pilots with continued emphasis on the 12 business operating principles for effective franchise fund management.

The second report, communicated to Congress in late 2000, provided the legislative justification that the franchise concept be made permanent and that the franchise fund concept be extended to other departments as well, with OMB involved in a more formal approval and monitoring role as more franchise funds were created.

The proposed legislation that was sent to the 106th Congress would have codified many of the franchise fund operating principles endorsed by OMB and the CFO Council. It also advocated a greater administrative role for OMB in the creation and oversight of franchise funds. Each franchise fund would be expected to have its own separate budget account, provide services on a full-cost basis, be subject to an annual financial audit, as well as being held to annual financial management performance goals and indicators. Furthermore, as many of the pilots were already doing, franchise funds would be able to retain up to 4 percent of annual receipts for capital, information technology, and financial management improvements. A significant new provision would have permitted new franchise funds to obtain at least partial funding through federal debt financing. As in the private sector, such debt would eventually have to be retired as the franchise fund became successful.

The Bush administration in its FY2002 budget proposed a one-year extension of the pilot franchise funds. However, at the same time, it has advocated more outsourcing of services through competitive sourcing and called for a more thorough scrutiny of the terms and conditions of inter-agency service projects.<sup>7</sup>

As of this writing, the Senate Governmental Affairs Committee has reported out legislation providing for a one-year extension of franchise funds—S.1198—and the full Senate approved it by a voice vote. The House of Representatives has yet to act on this legislation. However, a one-year extension for existing franchise funds was enacted as part of the FY2002 Treasury-Postal Appropriations bill.

In sum, the idea of franchise funds was driven largely through an executive branch process aided and abetted by interested agencies that wished to put these instrumentalities on a sounder legislative footing and thereby give them greater incentive for more aggressive agency and interagency cross-servicing. Bureaucratic entrepreneurs who headed these operations stood ready to market their services on a competitive basis and were given free rein to do so during the first several years that franchise funds existed. By 2000, these franchise funds had strong supporters in OMB and the CFOC, both of which recommended legislative permanence for the concept.

# Franchise Fund Pilots: An Overview

Six franchise fund pilots were created pursuant to the Government Management Reform Act of 1994. They operate in five departments and one independent agency and vary in size, scope of service offerings, governance structure, and the degree to which they provide service beyond the department's jurisdiction.

Five of the six franchise funds have been in operation since May of 1996 and one since January 1997. Thus, at the end of FY2001, they will have been in operation for the past five years. The Bush administration has requested a one-year extension of franchise funds in the FY2002 budget<sup>8</sup> while at the same time seeking a more thorough examination of interagency cross-servicing procedures.<sup>9</sup>

Once established, franchise funds were expected to operate according to 12 business operating principles (see Table 1).<sup>10</sup> These principles were enumerated to insure that these funds were to be truly entrepreneurial in nature and provide various administrative services on a fully voluntary, market-based basis to all interested government agencies.

The funds were expected to succeed on their own, having no subsidy from appropriated funds but financing their operations solely from the revenues received from their business operations. Most funds had authority to retain up to 4 percent of their earnings to finance either periodic upgrades of their infrastructure or cope with surges and contractions of business. However, accumulation of these funds was predicated on the assumption that their business operations were self-sustaining and that such business lines would succeed or fail

depending on their ability to attract and retain satisfied government customers. Or as Curtis Coy, director of the Program Support Center (PSC) at the Department of Health and Human Services, said, "Franchise funds are established to drive business processes and behavior towards efficiency—the better, faster, cheaper model."

The customers of franchise funds were to be government agencies within and outside of the departments or agencies in which the funds were located. Internal customers were valued because they could help produce rapid economies of scale in administrative agencies. In addition, internal customers were also seen as beneficial as departments or agencies sought to meet their downsizing FTE mandates from the Office of Management and Budget and Congress and contend with the fiscal pressures caused by declining program management budgets.

At the same time, other federal agency customers of franchise funds were an equally if not more important gauge of franchise fund success. Such external customers would also benefit from service economies of scale, but an increasing number of external customers would also indicate that the franchise fund was providing a high-quality, high-value service with a quality and cost mix that was superior to other providers. This competitive environment would put pressure on other franchise funds and/or other government service providers to enhance service quality and/or reduce the cost of their services to gain a competitive advantage, or else run the risk of losing customers or going out of business altogether.

**Table 1: The Franchise Fund Pilot Program, 12 Business Operating Principles**

<ol style="list-style-type: none"> <li>1. <b>Competition:</b> The provision of services should be on a fully competitive basis. The organization's operations should not be "sheltered" or be a monopoly.</li> <li>2. <b>Voluntary Exit:</b> Customers should be able to "exit" and go elsewhere for services after appropriate notification to the service provider and be permitted to choose other providers to obtain needed services.</li> <li>3. <b>Self-Sustaining/Full Cost Recovery:</b> The operation should be self-sustaining. Fees will be established to recover the "full costs," as defined by standards issued in accordance with FASAB [the Federal Accounting Standards Advisory Board].</li> <li>4. <b>Surge Capacity:</b> Resources to provide for "surge" capacity and peak business periods, capital investments, and new starts should be available.</li> <li>5. <b>FTE Accountability:</b> Full-Time Equivalents (FTEs) would be accounted for in a manner consistent with the Federal Workforce Restructuring Act and OMB requirements, such as Circular A-11.</li> <li>6. <b>Initial Capitalization:</b> Capitalization of franchises, administrative service, or other cross-servicing operations should include the appropriate FTE commensurate with the level of effort the operation has committed to perform.</li> <li>7. <b>Adjustments to Business Dynamics:</b> The ability to adjust capacity and resources up or down as business rises or falls, or as other conditions dictate, is necessary.</li> </ol>	<ol style="list-style-type: none"> <li>8. <b>Cessation of Activity:</b> The organization should specify that prior to curtailing or eliminating a service, the provider will give notice within a reasonable and mutually agreed time frame so the customer may obtain services elsewhere. Notice will also be given within a reasonable and mutually agreeable time frame to the provider when the customer elects to obtain services elsewhere.</li> <li>9. <b>Organization:</b> The organization would have a clearly defined organizational structure including readily identifiable delineation of responsibilities and functions and separately identifiable units for the purpose of accumulating and reporting revenues and costs. The funds of the organization must be separate and identifiable and not commingled with another organization.</li> <li>10. <b>Services:</b> The enterprise should provide only common administrative support services.</li> <li>11. <b>Performance Measures:</b> The organization must have a comprehensive set of performance measures to assess each service that is being offered.</li> <li>12. <b>Benchmarks:</b> Cost and performance benchmarks against other "competitors" are maintained and evaluated.</li> </ol>
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Source: OMB. 1997 Report on Franchise Funds

While franchise funds were expected to be competitive service providers within and outside of their departments, they were also expected to observe uniform rules of prudent and transparent financial management. They were expected to undergo independent, annual financial audits. They were to have full cost accounting and full cost recovery for their business operations. Furthermore, they were encouraged to monitor customer satisfaction, set performance objectives and measures, and engage in benchmarking. Benchmarking could enable franchise fund managers to better manage their costs, while incorporating lessons learned from the best practices of other organizations to measure the efficiency and effectiveness of their own operations and better manage their costs. Finally, they were expected to abide by all current laws and regulations dealing

with competition with other public and private sector service providers to government agencies.

Essentially these franchise funds were expected to be entrepreneurial in the truest sense of the word. They were to offer competitive, high-quality services. They could not "low ball" their service offerings since they could not run a fiscal deficit. They could not "pad" their bills since their services were required to be offered on a full cost recovery basis. Moreover, they had to have fully transparent pricing for their services and maintain continuous customer feedback as to the quality and cost of their service offerings.

What has been the general record of franchise funds during their existence? By a number of measures, franchise funds appear to have succeeded well in their service mission (see Tables 2, 3, and 4).

**Table 2: Initial Features of Franchise Fund Pilots**

Franchise Fund	CEO	Start Date	FY97 Rev. (\$millions)	FY97 FTE	Services Offered By Fund
Commerce Department	CFO	October 1996	\$12M	39	Acquisition management, financial services, engineering, environmental compliance, and IT services
HHS Department	Deputy Sec.	January 1997	\$81M	103	Clinical occupational health, environmental health, and employee assistance program services
Interior Department	Deputy CFO	October 1996	\$3M	12	Administrative, IT, facilities management, and training and development services
Treasury Department	Deputy CFO	July 1996	\$37M	84	Financial consulting, administrative management, accounting, financial systems, and financial education services
Veterans Affairs Department	Asst. Sec. Mgt.	October 1996	\$59M	433	IT and telecommunication, records management, law enforcement and investigations, and financial services
Environmental Protection Agency	CFO	October 1996	\$104M	65	IT, telecommunications and postal services

Source: OMB, *The Franchise Fund Pilot Program: An Interim Report, 1997*.

**Table 3: Selected Characteristics of Franchise Fund Pilots, FY97-FY98**

	Treasury	Interior	VA	EPA	HHS
<b>Sales Growth 1997-1998 (in \$millions)</b>	\$37-\$80M	\$3.4-\$19.3M	\$59.2-\$88M	\$104-\$111M	\$81-\$82M
<b>Full Time Equivalent (FTE) Employment Growth/Decline 1997-1998</b>	84-120 FTE	12-58 FTE	433-546 FTE	65-59 FTE	103-90 FTE
<b>Service Efficiencies Recorded 1997-1998</b>	7% Mail 27% Admin/ Support Cost Reductions	N.A.	83% Unit Rates Decreased	9.6-20% Cost savings for Business units	Reduced Clinical Training costs
<b>Full Cost Recovery Policies in Place</b>	Yes	No; not complete	Yes	No; not until 2000	Yes
<b>Unqualified Opinion on Financial Audit</b>	Yes Unqualified Opinion, FY97,98	Yes	Yes FY98 only	Yes Material Weakness	No Separate FOH Audit Performed

Source: OMB 1999 Report of Franchise Funds

**Table 4: Additional Characteristics of Franchise Fund Pilots, FY97–FY98**

	Treasury	Interior	VA	EPA	HHS
<b>% of Customers from External Agencies</b>	91% External	84% External	36% External	All Internal	93% External
<b>Service Provision on Voluntary Basis</b>	Yes	Yes	Yes	No	Yes
<b># of Competitive Service Bids Entered and Won</b>	50%/10 Bids No challenges	50%/4 Bids	100%/25 Bids	None	43%/21 Bids No challenges
<b>% of Business Handled by Private Sub-contractors, FY98</b>	84%	85%	50%	95%	87%

Source: OMB 1999 Report on Franchise Funds

Their overall record is perhaps best summarized by a 1999 report of the Entrepreneurial Government Committee of the Chief Financial Officers Council. The report stated, “Overall the franchising concept appears to be adding value to government operations, as foreseen by the NPR. During their first two years of operation, franchise funds have generated more than \$600 million in gross revenues through the delivery of common administrative services. Furthermore, nearly three-fourths of the revenue generated by these pilots is attributable to cross-servicing arrangements with external customers. Accompanying this impressive level of production across the pilot, many franchise funds have been able to support more effective or efficient operations of their customers by either reducing the costs and/or improving the quality of products and/or services provided—achieved, in part, through both competition and collaboration with other public and private sector providers.”<sup>11</sup> Put another way by Curtis Coy of the HHS Program Support Center, which now supervises the Federal Occupational Health (FOH): “The key element in a franchise fund is responsiveness. Government customers really want responsiveness and control over the services that they receive. The key here when competing for business is to shut up and listen to the customer.”

Franchise fund pilots discussed here have voluntary service offering policies, a successful service competition record, and deliver a large if not predominant part of their service through private sector subcontractors.

Sales growth has occurred during the early years, though some of the franchise funds have actually dropped some service lines because of declining customer demand and/or loss of business to other government service providers. FOH has revised some of its standard packages of services to better meet the service needs and price demands of its customers. More progress appears to be needed on some critical aspects of financial management, such as the conduct of annual financial audits, development and use of performance measures, and implementation of full cost recovery policies and practices—a critical element in franchise fund financial self-sufficiency.

The most recent assessment of franchise funds came at the end of 2000 during the closing days of the Clinton administration. This report, prepared by the CFO Council and presented to OMB, commented favorably on the success of the franchise fund concept since it encouraged agencies to consolidate administrative service provision and have such services provided on a competitive basis. It further noted the fiscal benefits of cross-servicing, the competitive spirit engendered by franchise funds, and the continuous ability of franchise fund customers to enter into and exit from service agreements with the funds. The report concluded by noting that proposed legislation making the franchise concept permanent and extending the concept to all government departments and agencies would “... help make franchise funds a better model for accountable, non-subsidized offerings of adminis-



trative services. ... As the franchise fund concept is expanded, future policy makers could consider whether the other non-appropriated funds should be subject to the same safeguards that franchise funds are."<sup>12</sup>

In summary, through the end of 2000, the franchise concept appears, for the most part, to have proven its worth and lived up to the initial expectations of its founders. Franchise funds:

- Increased sales volume, especially on cross-servicing agencies;
- Operated on a voluntary fee-for-service basis; and
- Provided the bulk of their service through small-business subcontractors and did so with a high degree of customer satisfaction.

To that end, they received the endorsement of OMB and the CFOC to propose permanence for the franchise fund concept and to extend it to other departments with OMB approval.

While this summary assessment of franchise funds is helpful, a more detailed look at two franchise funds in the Department of Health and Human Services and the Treasury Department is now in order.

# Franchise Funds: Two Case Studies

This part of the report examines in more detail the operations of two specific franchise funds: the HHS franchise fund—the Federal Occupational Health (FOH)—and the Department of the Treasury Franchise Fund (TFF).

Public records of the funds were examined and a series of in-depth interviews were held with senior governmental officials responsible for or familiar with the operations of these funds.

## Federal Occupational Health (FOH)

The FOH was the last franchise pilot to be established under the Government Management Reform Act. Yet, the FOH had a long history in the provision of basic occupational health services, formerly being a part of the hospitals and clinics division of the Health Resources and Services Administration (HRSA). By 1984-85 as part of a cost-cutting initiative of the Reagan administration, FOH was directed to be funded on a wholly reimbursable basis from the government customers that it served. Senior HHS officials at the time took FOH into the fee-for-service arena and operated it on a fully reimbursable basis, with annual sales totaling \$50 million by 1993.

The FOH was recommended to be a franchise fund by John Hisle, director of FOH, and Dr. Ernest Hardaway, deputy director of FOH, who had been an agency representative to the National Performance Review and was active in developing the franchise concept. Other officials at HHS, including the secretary, deputy secretary, CFO, and deputy CFO, strongly endorsed this recommendation and requested that OMB designate the FOH as

a franchise fund. While some internal consideration was given to designating the newly created Program Support Center at HHS as a franchise fund, the complex operations and financing of the PSC suggested that a smaller, more focused franchise fund be created, hence the choice of FOH as the department's designated franchise fund.

As John Hisle said, "The franchise fund designation gave us the 'Good Housekeeping Seal of Approval.' It also helped us retain up to 4 percent of our revenues, which aided with our business development efforts and further helped us deal with the surge and flow of FOH business."

John Hisle was named to head FOH in 1993, and he changed in a fairly dramatic way the operation of the FOH. Previously it had operated on a decentralized basis with business being generated from 10 regional FOH offices. Hisle moved away from this decentralized, regional approach toward a more centralized one that could compete for national contracts with a uniform rate structure.

Currently the FOH has 84 "core" FTE and over 1,600 persons who are hired through a variety of contractual agreements (both on a part-time and full-time basis). Of particular interest is the teaming effort that FOH has with the Magellen Corporation. Magellen contracts with FOH to provide Employee Assistance Program services and at the same time it has a non-compete clause with the FOH. This arrangement benefits contractors since they obtain a guaranteed line of business and basically supply services as set forth in a service agreement developed by the FOH. Thus, the FOH, in effect,

becomes a financial intermediary for Magellen and other subcontractors and insures that a private contractor delivers effectively the services for the government customer.

At the same time, there is competition between the FOH and other federal fee-for-service instrumentalities (i.e., CASUs) and with private providers like Ceridian that provide Employer Assistance Program services on the GSA schedule, something that the FOH is prohibited from doing. But the FOH ascribes its success to its responsiveness to the customer. It seeks to provide a high-quality service at a reasonable price. This indicates that the FOH is selective in what work it competes for. FOH does not compete with low-end public or private sector

providers who offer lower value occupational programs at substantially lower costs. Again, as FOH Director Hisle states, "The FOH prides itself on the quality of its services. We pride ourselves on this point. We will not offer low-quality services even if they can be delivered at a cut-rate price."

Past business plans for the FOH projected \$87 million in revenue in FY2000 rising to \$96 million in FY2002. The FOH projects an annual growth rate of 5 percent or more in sales in 2002 and beyond due to developing a more skilled marketing workforce, greater outreach to a wider range of federal agencies, and a continued high-quality "branding" of their services (see Tables 5 and 6 and Figure 1).

**Table 5: Services Offered by Divisions of the Federal Occupational Health**

Occupational Health Services Division		Federal Law Enforcement Medical Program Division	
Basic Occupational Health Services	Specialized Clinical Services	Environmental Health Services	Employee Assistance Program
<ul style="list-style-type: none"> <li>• Walk-in care and first emergency response</li> <li>• Personal physician services</li> <li>• Health education programs</li> <li>• Annual workplace visits</li> <li>• Ongoing health screenings</li> <li>• Individualized health counseling</li> <li>• Occupational health records</li> <li>• Routine immunizations</li> </ul>	<ul style="list-style-type: none"> <li>• Medicare surveillance services</li> <li>• Specialized physical examinations</li> <li>• Medical clearance examinations</li> <li>• Occupational health consultation</li> <li>• Medical opinions on ADA [Americans with Disabilities Act] and Family Leave Act matters</li> <li>• Education and training on disease control and management</li> <li>• Illegal drug-use detection programs</li> <li>• Individual/corporate health-risk appraisals</li> <li>• Defibrillator training and quality assurance</li> <li>• Smoking cessation programs</li> </ul>	<ul style="list-style-type: none"> <li>• Industrial hygiene surveys</li> <li>• Environmental surveys</li> <li>• Workplace safety surveys</li> <li>• Training in hazardous exposure protection</li> <li>• Hazard surveillance and risk assessment</li> <li>• Occupational health and safety program assessment</li> <li>• Environmental sampling and laboratory services</li> </ul>	<ul style="list-style-type: none"> <li>• Supervisor consultation and training</li> <li>• Short-term problem resolution</li> <li>• Community resource referral</li> <li>• Crisis counseling</li> <li>• Health promotion</li> <li>• Family support services (Department of Defense primarily)</li> <li>• Dependent care and referral services</li> <li>• Workplace violence prevention</li> </ul>

Source: FOH FY2000-2002 Business Plan

**Table 6: Federal Occupational Health  
Top 12 Customers (FY99 Billings)**

Rank	Customers	FY99 Billings
1.	U.S. Postal Service	\$24,771,637
2.	Treasury	10,005,082
3.	Justice	6,228,388
4.	Environmental Protection Agency	5,033,584
5.	Health and Human Services	4,903,432
6.	Army	4,439,459
7.	Interior	2,959,088
8.	Social Security Administration	2,621,042
9.	General Services Administration	2,510,755
10.	Defense	2,411,164
11.	Agriculture	2,180,258
12.	U.S. Courts	2,067,344

Source: Federal Occupational Health

The FOH is a geographically dispersed service provider. It has 210 permanent clinical service locations, 290 counseling service centers in 50 states, and 52 wellness/fitness centers operating throughout the country.<sup>13</sup>

The FOH services 1.2 million federal employees with its Employee Assistance Program (EAP) services; 200,000 employees with basic clinical services; and another 500,000 employees with specialized clinical or EAP services. All in all, 493 separate organizations have concluded service agreements with the FOH.

The history of the FOH suggests that it has become attuned to changing customer service needs and, therefore, has been able to expand and diversify its service offerings over time. It has noted a gradual shift from basic occupational health services (BOCHS) to other specialized clinical, environmental, and employee assistance programs. The move-

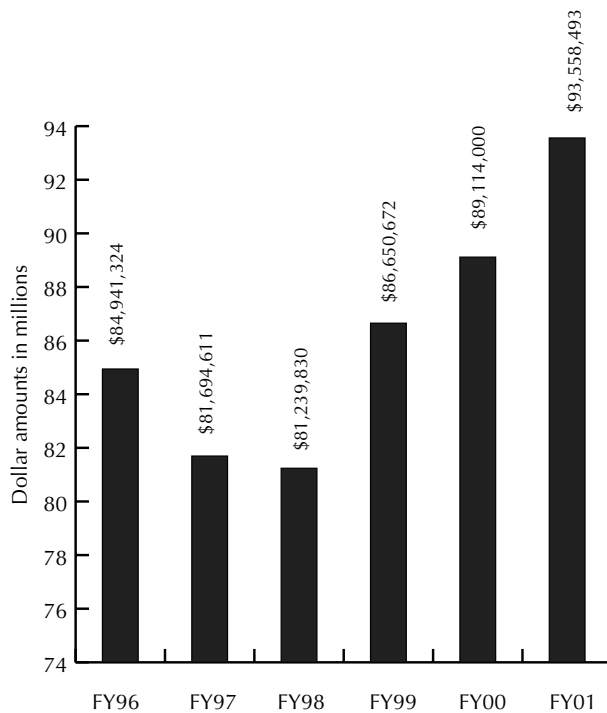
ment here suggests that agency customers were expanding service agreements pursuant to various labor agreements and also due to their desire to customize their specialized clinical service offerings from among those that were being offered by the FOH. As a result, specialized clinical service agreements produced 60 percent of all clinical product line revenues by FY2000.

One example of the ability of the FOH to offer new services on a fast-paced basis was the agreement between the FOH and the U.S. Army to provide anthrax inoculation and other specialized medical services to the Army on an as-needed basis. After approval by the HHS Service and Supply Fund Board and the department, the FOH offered the service so that the Army could better utilize in-house personnel and reduce the maintenance of fixed locations for such services. Thus, the FOH provided the service on an as-needed and just-in-time basis.

Yet, in another case, the FOH sought approval to supply environmental remediation services to the U.S. Navy at selected environmentally contaminated "surplus" Navy base sites. This proposal was turned down by the HHS Service and Supply Fund Board when it was determined that HHS might have to assume legal liability for the sites once FOH services were offered at the locations. So even though the FOH was aggressive in seeking new business opportunities, other overriding considerations prevented this new FOH business venture.

A number of factors appear to have contributed to the FOH's service success in its first several years of operation. On the fiscal front, it had a healthy level of retained earnings and was able to offer lower rates for some of its offerings, especially EAP services. It could also document substantial dollar savings for some of its customers after they received service from the FOH.

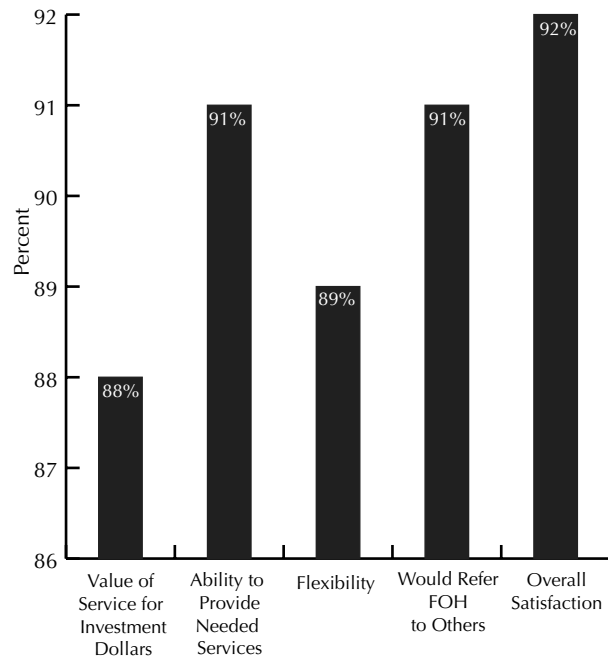
Perhaps the most important feature of the FOH was its intense attention to customer service. "Core" staff continuously monitored customer service and was insistent that FOH subcontractors maintain high-quality service levels. In this regard, they appear to have been aided by their subcontractors, many of which were small businesses eager to maintain their business with the government. These small businesses found that the FOH could act as a

**Figure 1: Total FOH Revenue by Year, FY96–FY01**

Source: Federal Occupational Health

general contractor for their services. The FOH could design and negotiate a service agreement with an agency, and the subcontractor would simply execute the contract. This arrangement assured a revenue stream for the subcontractor but continued to enhance the ability of the FOH to negotiate and monitor service-level agreements.

In sum, the FOH has developed as a successful franchise fund and fulfilled its promise as a vehicle for public-service entrepreneurship. It has offered services consistent with its mission. It has done so through carefully crafted service agreements and backed this up with continuous monitoring of customer satisfaction with service offerings. Its “customer first” spirit, its efforts to hold down unit costs of service where possible, and its ability to offer new and custom-tailored services to its customers have insured its success as a franchise fund (see Figure 2). In sum, as a senior HHS official, Deputy CFO George Strader, put it, “The Federal Occupational Health franchise fund is well connected to its original mission and has excellent entrance and exit rules for its customers.”

**Figure 2: Summary of FY2000 FOH Customer Satisfaction Survey—% of Customers Who Rated FOH “Excellent” or “Good” on Selected Measures**

Source: Federal Occupational Health FY2000 Business Plan

## Treasury Franchise Fund (TFF)

The Treasury Franchise Fund (TFF) was designated as a pilot in 1996, and its first year of full operation was FY97. The TFF originally had five units—the Center for Applied Financial Management and four CASUs that were administered by the Internal Revenue Service and that operated in Baltimore, Los Angeles, Cincinnati, and Seattle. Since there were a variety of separate fee-for-service instrumentalities operating within Treasury, it was felt that the TFF would be a “holding company” for these units and thereby promote more systematic franchising.

The TFF was created according to a highly systematic process, guided in some measure by the NPR operating principles for franchise funds. Detailed risk-assessment studies were conducted, and the TFF charter was designed with input from a wide variety of Treasury officials including the inspector general. They also helped draft a rigorous set of rules for any Treasury entity that wished to come under the umbrella of the TFF. The main rules were: 1) no subsidy for operating costs, 2) total cost

accounting for all services rendered, 3) quarterly financial statements, 4) annual financial audits, and 5) benchmarks for service.

Additional units have been brought into the TFF over time, with the major addition being the Administrative Reserve Center (ARC), located in Parkersburg, West Virginia. This has become the most successful business unit in TFF and has been adding customers both inside and outside of the Treasury Department.

Business offerings have increased substantially during the history of the TFF (see Tables 7 and 8). The most successful business unit, the ARC, first sought business from small government agencies and then expanded to the D.C. Pensions Board and the Financial Management Service in Treasury. Senior Treasury officials describe the success of this burgeoning service unit as coming from an entrepreneurial spirit that just “drips customer service.” Or as Barry Hudson, director of the Office of Financial Management, put it, “The Treasury Franchise Fund is distinguished by the fact that we understand our customers better than anyone else. This is even better than, say, going through a GSA schedule for service where there is not an intimate, continuous relationship between the provider and the customer.”

At the same time TFF CASU units have dropped some product offerings, such as conference services, and all Treasury Franchise Fund business units are under constant scrutiny to insure that their business offerings do not operate at a loss.

The TFF is governed by the deputy chief financial officer and the director of the Office of Financial Management. These chief officers hold quarterly meetings at which the Treasury inspector general and all directors of the business units of the TFF must attend. Quarterly financial statements are prepared for all TFF units and examined at these meetings, again to insure that all services being offered will be done on a self-sustaining basis (see Table 9).

The TFF currently has 11 business units, offering 30 distinct products or services to nearly 1,500 customers. They have a “core” staff of 490 employees, yet 83 percent of their revenues go to private subcontractors. Their revenue has grown from \$38 mil-

**Table 7: Services Offered by Treasury Franchise Fund**

- Accounting Services
- Alternative Dispute Resolution
- Auditor Training
- Background Investigations
- Collaborative Consulting with Leaders
- Computer Repair Maintenance
- Conference Room Management
- Copier Management
- Court Reporter Services
- Employee Assistance Programs
- Equipment Rental
- Federal Benefits Information Systems
- Financial Education and Training
- Financial Management Consulting
- Financial Systems Consulting
- Laser Cartridge Services
- Leasing
- Mail Room and Management Services
- Messenger Service
- Moving Services
- Personnel Services
- Procurement Services
- Records Management Destruction
- Resource Management Program
- Space Planning and Design
- Telecommuting Services
- Temporary Help
- Training Services

*Source: Department of the Treasury Franchise Fund 2000 Accountability/Annual Report*

lion in FY1997 to \$165 million in FY2000, and they have doubled their number of external customers in four years of operation (see Figures 3, 4, 5, and 6).

The TFF also notes that customers using their services have reduced administrative costs as part of their overall budget from 7.3 to 5.5 percent. This has helped these customers move toward greater consolidation of such administrative support services as accounting, procurement, travel, and personnel services.

**Table 8: Treasury Franchise Fund Business Organization & Units**

<b>Consolidated/Integrated Administrative Management</b>	<b>Financial Systems Consulting and Training</b>	<b>Financial Management Administrative Support</b>
FBA Central FBA East FBA Midwest FBA St. Louis FBA San Antonio FBA West FBA Seattle	Center for Applied Financial Management  Financial Consulting Group  Inspectors General Auditor/ Training Institute	Administrative Resource Center

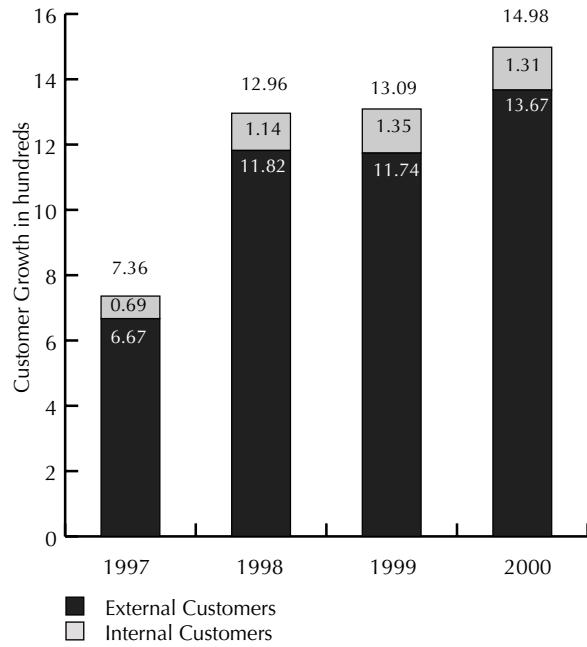
Source: U.S. Department of Treasury, 2000 Accountability/Annual Report

**Table 9: Treasury Franchise Fund—Progress in Meeting Performance Goals**

	<b>Benchmark</b>	<b>FY2000</b>	<b>FY1999</b>
<b>Goal: Ensure Business Activities are Self-Sufficient</b>			
1. Annual financial results are equal to or greater than break-even (total expenses equal total revenues)	Positive Net Position	Met	Met
2. Current Ratio	1.2	1.2	1.4
<b>Goal: Customer Satisfaction</b>			
1. Satisfaction Approval Rating	80% Approval	Exceeded	Exceeded
2. Sales Volume Growth	10% increase	20%	72%
3. Growth or Decline of Customer Base	10% increase	57%	1%
<b>Goal: Ensure Compliance with Legal &amp; Regulatory Requirements</b>			
1. Results of Management Controls Reviews	No Deficiencies	Met	Met
2. Results of Annual Audit	Unqualified "Clean" Opinion	Met	Met
<b>Goal: Ensure Competitiveness</b>			
1. Program Voluntary	All agreements have customer escape clause	Met	Met
2. Growth in Customer Base	10% increase	14%	1%

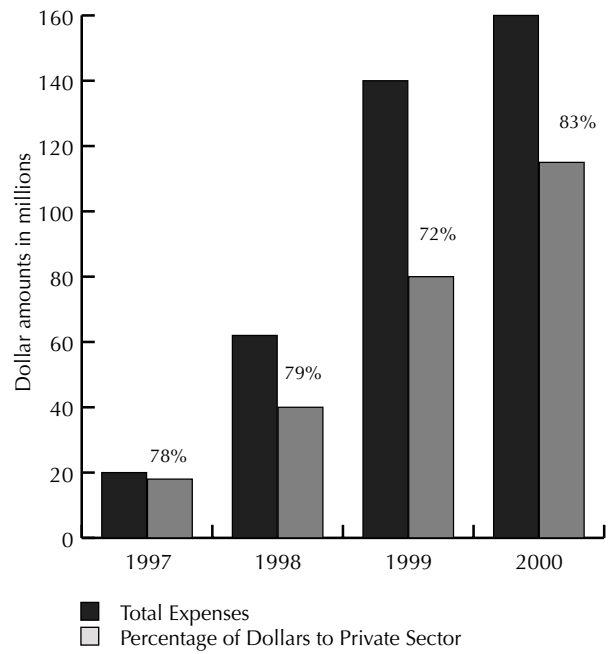
Source: Department of the Treasury Franchise Fund 2000 Accountability/Annual Report

**Figure 3: Treasury Franchise Fund 1997-2000**



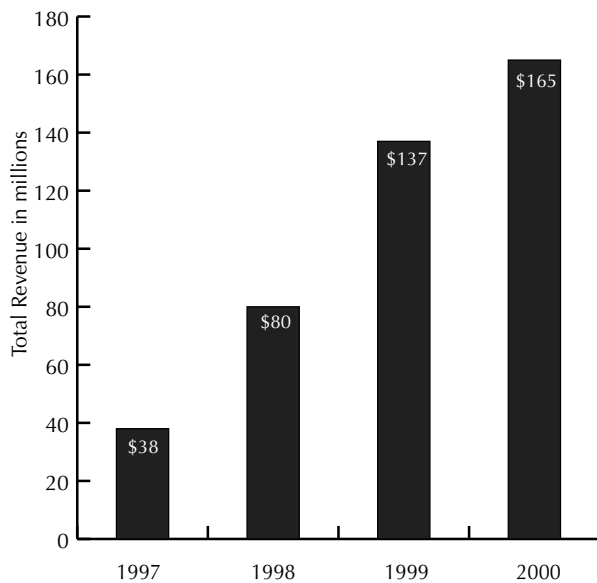
Source: Treasury Franchise Fund  
 Note: Customers = number of separate service agreements with entities inside and outside of the Treasury Department

**Figure 5: Treasury Franchise Fund Private Sector Participation**



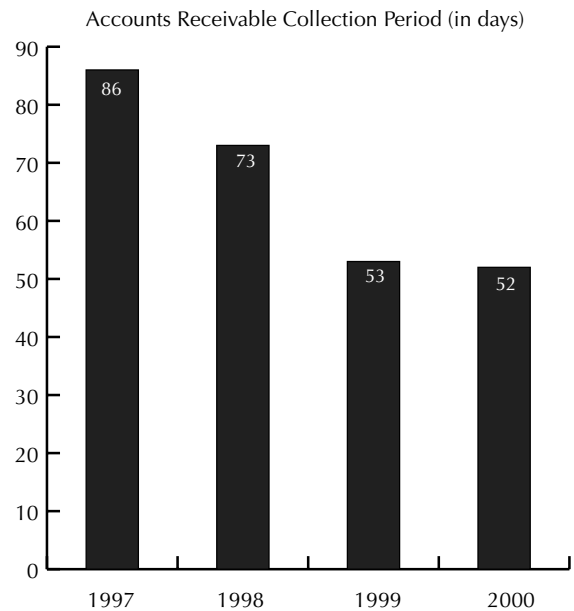
Source: Treasury Franchise Fund

**Figure 4: Treasury Franchise Fund Revenue Growth 1997-2000**



Source: Treasury Franchise Fund

**Figure 6: Accounts Receivable Collection Trends FY1997-2000**



Source: Treasury Franchise Fund



The TFF has many elements of success similar to that of the FOH. It has a large and growing number of customers; its sales volume has increased dramatically. The strength of its core mission has meant a considerable plus in marketing its services within and outside of Treasury.

More so than FOH, the TFF has prided itself on its full cost accounting and its unqualified financial opinions over the years. It is scrupulous in following the various federal financial mandates, ranging from OMB Circular A-76 to various Statements of Federal Financial Accounting Standards (SFFAS), and it has maintained a positive net position in its fiscal statements since its inception.

Other principal reasons for success appear to be the TFF's determination to have all its business units operate on a self-sustaining basis and not to impose rigid hierarchical rules and regulations on them. Also, they have greatly expanded their private subcontractor base as noted in their annual financial statements. Yet, at the same time they have successfully insisted on a strong customer-service ethos on the part of their service managers and vigorously demonstrated how agency use of their services can reduce customer administrative costs.

At the same time, Treasury officials are concerned about a series of future issues. First, they see the need for permanent reauthorization of the franchise fund legislation if the TFF is to remain in business. As Steve App, deputy CFO at Treasury, put it, "If the franchise fund legislation is not made permanent, we will suffer. We are still viewed as pilots. Without permanency, we eventually will not succeed." Second, they see the need for strong succession planning for "core" TFF managers, and they fear the loss of institutional knowledge due to impending retirements of TFF staff. Finally, although it is a muted concern, they are anxious to insure that there is a level playing field among franchise funds and like instrumentalities in the competition for service offerings, a problem that sometimes extends to the component service units of the TFF.

Unlike the FOH, the TFF is really a holding company for a variety of component fee-for-service units that once operated independently within Treasury. Its governing board does not include political appointees like that of the HHS Service

and Supply Fund Board, to which the FOH ultimately reports. Moreover, TFF's dramatic sales growth, excellent record in meeting financial management mandates, and generally superior fiscal position do distinguish it from the FOH.

Both franchise funds have specific strengths and weaknesses and concerns, but they both demonstrate that franchise funds can be successful service entrepreneurs. They can be truly customer centered and be so without relying on internal subsidies, all the while providing high-quality services on a fully competitive basis.

# Franchise Funds: Criteria for Evaluation

The franchise fund pilots have been in operation for several years. So by what measure have they been successful or not? While this report does not examine in full detail the operations of all franchise funds, it is important to provide some criteria by which one can judge their successes and shortcomings.

One key way of evaluating the success of the franchise fund pilots would be to determine whether they have adhered to the 12 business operating principles jointly developed by the National Performance Review, Chief Financial Officers Council, and the Office of Management and Budget (see page 12). A second broad criterion would be to assess whether the operations of these mechanisms were better than traditional methods of providing service—either keeping the service in house or contracting it out by traditional methods.

Three of the operating principles—competition, voluntary exit, and full cost recovery—appear to have been well met by the franchise funds studied in this report. Customers are free to seek or terminate service offerings from the FOH and the TFF. Both franchise fund pilots have engaged in processes whereby they compete for customers; they have both won and lost these competitions according to prescribed A-76 rules, and when they have won these competitions, their successful bids have not been challenged. Both franchise funds have lost customers during the time they have been in existence, and they have dropped or modified business offerings that have been found not to be self-sustaining. Also, both funds have maintained their services on a full cost recovery basis, with the Treasury Franchise Fund reviewing the fiscal status

of all their business units on a quarterly basis. With regard to these principles, these two franchise funds are truly voluntary in nature; they have provided their customers with alternative means to providing service either in house or through total outsourcing. To that end, they have ended the inefficient internal government service monopolies that the National Performance Review found to be so wasteful.

The next broad set of business operating principles—capacity to accommodate business growth, FTE accountability, initial capitalization, adjustments to business dynamics, and cessation of activity—are principles that the two studied franchise funds have largely, but not completely, adhered to.

Both franchise fund pilots have been adequately capitalized and thus have had a sound fiscal footing by which to undertake their operations. It appears that the TFF had a greater level of initial capitalization and, with an expanding customer base, has not had to fully use that capitalization over time. The FOH, on the other hand, did lose some business when a major customer—the U.S. Postal Service—modified their business with the FOH. Overall revenues for a brief period actually declined somewhat, and the FOH did have to dip into their capital reserve to adjust for the business loss, all the while continuing to assess ways of revising their pricing structure to encourage more business over the long term.

The record of these two franchise funds with regard to surge capacity to accommodate business growth, adjustments to business dynamics, and cessation of activity also appears to be positive. The record of

both franchise funds in attracting new customers, especially that of the TFF, is notable. Two major customer service initiatives undertaken by the FOH, one with the U.S. Army and the other with the U.S. Navy, one successful and the other unsuccessful, also highlight FOH's aggressiveness in seeking new business opportunities. And while both franchise funds have dropped or revised services on occasion, this elimination or revision of services was done without any damage to exiting customers or their customer base.

With regard to FTE accountability, the author can find no record of dissatisfaction with franchise fund staffing on the OMB front. While franchise funds were specifically exempted by OMB and the President's Management Council from the government-wide FTE ceilings imposed by the Workforce Restructuring Act, it is fair to say that both franchise funds see their FTE policies as a means to an end—that of providing superior service to their customers. Both franchise funds emphasize that their “core” employees should be customer-centric in their approach to franchise fund operations. They both provide resources to help their core employees become better service marketers and service managers, and both are concerned that impending retirements and lack of suitable pay and benefits may eventually erode the ability of these core employees to sustain the business successes over the long run.

The last set of operating principles—organizational structure, the provision of common administrative services, performance measures, and benchmarks—is an area where these franchise funds do not fully follow the business operating principles, and to some degree with good reason.

Both franchise funds have well-defined organizational structures. The TFF is in reality a holding company for 11 distinct business units. These units all report quarterly on their business operations and finances to the Treasury deputy CFO and the director of financial operations, and all their business units have to be self-sustaining, or face the possibility of going out of business. The FOH is headed by a director who supervises a relatively small core staff, who in turn are in charge of several business lines throughout the country. These core employees

are responsible for managing service contracts with government agencies and the subcontractors that provide the actual service. The director now reports to the director of the HHS Program Support Center and the HHS Service and Supply Fund, headed by the HHS deputy secretary. The funding of both organizations is, of course, entirely separate from any other organizations, and the business units in the franchise funds have operated on a self-sustaining basis.

Both franchise funds provide common administrative support services, though the definition of such services has certainly changed over time. Thus, the FOH service offerings have changed from providing basic occupational health services to also providing new services such as the work/life component of its employee assistance programs, an example of benefits that often accrue to federal employees as a result of labor management contracts put in place in recent years. In the same vein, TFF services provided by that franchise fund's business units sometimes extend to such services as the safe disposal of medical waste.

With regard to performance measures and benchmarks to measure services against competitors, the two franchise funds do not follow fully the business operating principles to the letter and with some reason. First, their core staffs are relatively lean and almost fully devoted to managing customer accounts and service needs. While they do customer satisfaction surveys and respond almost on the spot to customer concerns, they do not have the time or the luxury to develop overly elaborate performance measures or perform extensive benchmarking. This, in some ways, is an overhead function that does not command the attention of franchise fund personnel. They are first and foremost interested in obtaining and retaining service customers, who are the best judge of whether franchise funds meet the needs of their government agencies.

Thus, the two franchise funds appear to meet the bulk of the business operating principles. They are competitive, voluntary, self-sustaining, customer centered, and prudently managed. In that sense they do adhere, in the main, to the business operating principles that were set forth to guide the operation of franchise funds.

Another broad-gauged criterion to judge the success or shortcomings of franchise funds is to ask the question of whether these mechanisms add value to the federal financial landscape. Are they superior to providing these services in a traditional manner, either by maintaining them in house or by fully contracting them out to the private sector?

Here again, franchise funds should be given favorable marks. So by what grounds can they be viewed as successful? First, their record of customer satisfaction and customer growth is a strong indicator of their success. Government managers chose in large numbers to do business with these entities. They did so because they were treated like true customers—they could define the terms and conditions of their service requirements, and they could obtain these services at a reasonable price. Moreover, with respect to both the TFF and the FOH, they respected the depth of traditional expertise brought to bear by these instrumentalities on the services that they offered.

Second, the private sector benefited from the use of franchise funds. Private contractors conducted the bulk of the day-to-day operations of these franchise funds, the bulk of whom were small business concerns, many of whom might otherwise not have provided services to the government. With the franchise fund as a financial and management intermediary, businesses were able to offer their services without going through a time-consuming and otherwise expensive process of bidding for a government service. In short, the franchise fund negotiated the prime contract with the department or agency, set up the terms and conditions for providing the service, and then expeditiously moved to select a subcontractor. So while business expertise and efficiency was directed toward the delivery of the service, overall management of the service rested with the franchise fund. This was a division of labor that greatly benefited the private sector.

Benefits also accrued to the government as well. First, franchise fund managers—the core personnel of the franchise fund—became skilled service marketers and service managers in the process. They continually engaged with government customers to understand and define their service needs. They negotiated service contracts that provided services at a reasonable price, and they expertly managed

the private subcontractors that provided the service. In effect, they became general contractors for the provision of selected administrative services, insuring that the services offered to the department or agency were characterized by high quality, reasonable cost, and timely responsiveness. So the government achieved the benefit of developing a cadre of “government-business” professionals who could structure and manage service contracts in a fully entrepreneurial manner.

Finally, the government benefited by the ability to retain some of the “inherently governmental” nature of the government service-contracting process. Too often, federal agencies, in fully offloading services to the private sector, may lose the ability to effectively manage and/or monitor their private sector service providers. When the government customer loses the knowledge base and the skill sets needed to manage a service contract, the door can be left wide open to service inefficiencies and cost overruns. With franchise funds this does not appear to be the case. These funds maintain a critical mass of “core” employees that can expertly structure and manage service contracts. They know the business lines that their funds are offering; they maintain continuous customer contact about their service offerings; and they come to know the expertise and efficiency of their private subcontractors. And since they are governmental employees, they recognize the fact that the provision of their administrative support services helps the support of the overall mission of the government customer they are there to serve.

So do franchise funds make a difference? Are they useful means of providing a government service? Are they a constructive alternative to continuing to provide a service entirely by the government or entirely by a private sector concern? The answer to all three questions is a resounding “yes”!

While every individual franchise fund must be evaluated on its own record, the concept is sound, and the two franchise fund pilots studied in this report suggest that federal decision makers would do well to embrace strongly this service mechanism as a way of doing business in government in the years ahead.

# Recommendations

Franchise funds have operated on a pilot basis for the past five years. It now remains for the executive branch and the Congress to determine their future. Based on this report, the following recommendations are in order. These recommendations are directed to the Congress, the executive branch, the General Accounting Office, and the Office of Management and Budget.

## Recommendations for the Congress

First, the Congress should pass legislation that permanently authorizes the franchise concept.

Second, in passing this authorizing legislation, the Congress should also extend the franchise fund concept to other agencies. The “pilot” franchise funds are proof-of-concept that service franchising can work. Therefore, the Congress should permit all departments and independent agencies to set up franchise funds that operate according to the same principles that now govern the operation of existing franchise funds.

Such new authorizing legislation should require each department and independent agency to survey all fee-for-service instrumentalities within their jurisdiction to determine whether they are operating according to the same financial management and service delivery principles as existing franchise funds. The goal here would be to determine whether these fee-for-service instrumentalities should be recast as separate franchise funds or subsumed by other existing franchise funds. As Michael Serlin, former senior NPR official who helped bring the franchise fund concept into operation, said, “Franchise funds should be established

with permanent legislation. More agencies should be given authorization for such a fund, or series of funds, to help reduce the overhead cost of government. Moreover, every intra-government fee-for-service organization should be put on a plan, a glide path, to meet the same standards and become a true franchise fund.”

Finally, congressional legislation should require GAO to undertake a comprehensive review of franchise funds every three to five years to determine their continuing viability and also to assess the ways in which the “best practices” of various franchise funds can be transmitted to all franchise funds.

## Recommendations for Executive Departments

First, the heads of all departments and independent agencies should survey all franchise funds and similar fee-for-service operations within their jurisdiction. This survey would assess whether the franchises are achieving the objectives of GMRA and are properly applying relevant business operating principles. The survey would also assess the price and quality of their service offerings, their cost-recovery policies, and whether their services are offered on a fully voluntary basis. Additionally, analysis should be conducted as to whether franchise funds and fee-for-service instrumentalities have engaged in A-76 competitions and undergone thorough FAIR Act analyses. This would help departments determine whether various fee-for-service instrumentalities should be set up as independent franchise funds or consolidated into other franchise funds.

Second, departments and independent agencies should determine whether their component organizations are effectively utilizing existing franchise funds or fee-for-service instrumentalities that would be potential franchise funds, instead of continuing to provide common administrative services on an in-house basis. Here studies should be made of the true costs of providing services according to the quality and responsiveness of the service required by the customer. Costs, service quality, and responsiveness could be combined in a service-level agreement that could provide the basis of whether the service in question should be provided wholly by the government, by a suitable franchise fund, or be totally outsourced to the private sector.

Third, department and agency heads should insure that all franchise funds and fee-for-service instrumentalities that administer services most commonly provided by franchise funds are developing and implementing performance measures. This service analysis should, of course, become an integral part of a department's or agency's annual budget process.

Finally, departments and agencies should also insure that "core" franchise fund federal employees be trained as high-quality service marketers and managers, adept at improving service quality and reducing service costs through improved business practices. To that end, such employees should be accorded suitable innovative pay and benefits. This would be essential to help franchise funds continue their basic role as service intermediaries that would seek out service customers and manage high-quality service providers from both the public and private sectors.

## Recommendations for the General Accounting Office

The General Accounting Office should maintain constructive financial management oversight of franchise funds and insure that all franchise funds practice full cost recovery and undergo annual financial audits. Independent GAO review of these financial management concerns will provide constructive guidance to the Congress, OMB, and executive departments about the financial integrity and service efficiency of these service providers.

## Recommendations for the Office of Management and Budget

First, the Office of Management and Budget should maintain a full inventory of all franchise funds as well as other fee-for-service instrumentalities that might become franchise funds. Continuing analysis of this inventory will enable the OMB to develop plans for the expansion, consolidation, or termination of franchise funds.

Second, the deputy director for management at OMB should produce, as part of the annual federal budget, a comprehensive analysis of the business operations of franchise funds in the federal government along with recommendations for improved service delivery and service management by these funds. These recommendations might also take the form of annual legislative submissions to the Congress as well.

Third, OMB should have a role in the creation of new franchise funds. It should set up and maintain service and financial management criteria that should be met by new franchise funds, but it should not have blanket authority to prevent the creation of new franchise funds if they meet the preset criteria set forth by the OMB. OMB also should not recommend preset levels or quality of services to be offered by franchise funds. Franchise funds have proven their value to their customers without meeting such predetermined service requirements. Customers, through their individual service-level agreements with franchise funds, should negotiate these service offerings. They can punish franchise funds that do not meet these service levels by seeking alternative service providers. This is the best means of insuring satisfactory customer service.

Finally, OMB has an important oversight role in monitoring appropriate competition among franchise funds. A balance might have to be struck to insure that overly large franchise funds do not dominate the service field whether within or among departments or agencies while at the same time encouraging the highest-quality franchise funds to be the "best practices model" for other franchise funds. This could lead to a future where a few specialized franchise funds could offer their services on

a competitive basis to all governmental agencies, with the resulting competition providing the best means of raising service quality and maintaining suitable costs for franchise fund service offerings.

## **Conclusion**

The franchise fund experiment has been a success. Franchise fund pilots have provided quality services and registered considerable customer satisfaction in doing so. They have conducted their operations in a fiscally sound and prudent manner, and they have advanced the goal of entrepreneurial service competition in the federal sector. Accordingly, franchise funds should become a permanent and expanding part of the service-provider network in the federal government.

# Endnotes

1. *Black's Law Dictionary* (West Publishing Co., revised fourth edition), p. 786.
2. Graham Reynolds, R.E. Baxter, and Evan Davis, *Penguin Dictionary of Economics* (London: Penguin Books, 1998), p. 162.
3. National Performance Review (NPR), "'Franchise' Internal Services," *Improving Financial Management* (Accompanying Report of the National Performance Review) (Washington, D.C., NPR, 1993), p. 41.
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