

Delivering public sector efficiencies

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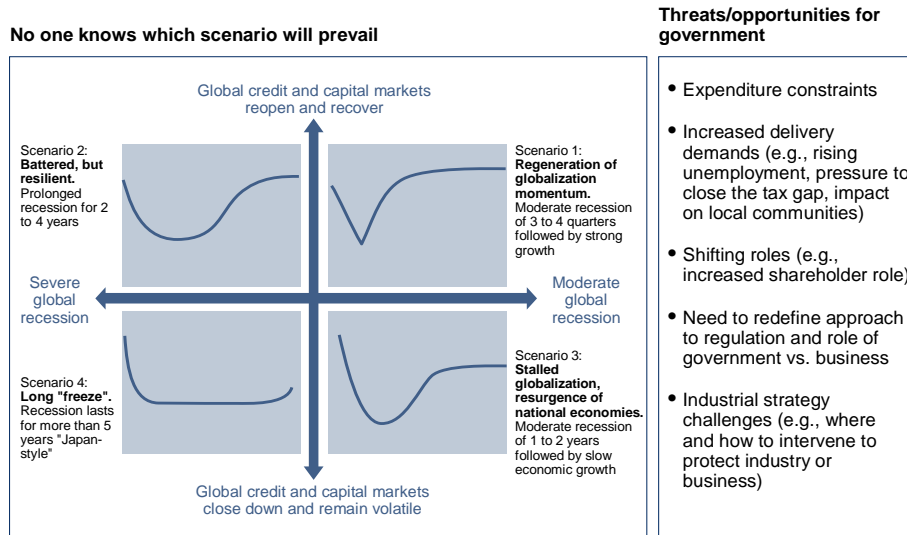
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Delivering public sector efficiencies

The current economic environment is creating unprecedented volatility and challenges for both public and private sector organizations. Within the public sector the need to find efficiencies will become acute as governments are forced to cut back spending to bring public finances back into balance over the medium term. However, the public sector also faces serious short-term policy and delivery challenges as it seeks to ameliorate the impact of the current downturn on citizens, families and businesses.

The future is inherently unknowable, but all likely scenarios call for organizational transformation to create efficiencies while preserving – and often enhancing – policy and delivery capabilities (Exhibit 1). Organizations across sectors must plan for uncertainty and adapt to a changing economic context.

Exhibit 1: Organizations face radically uncertain times

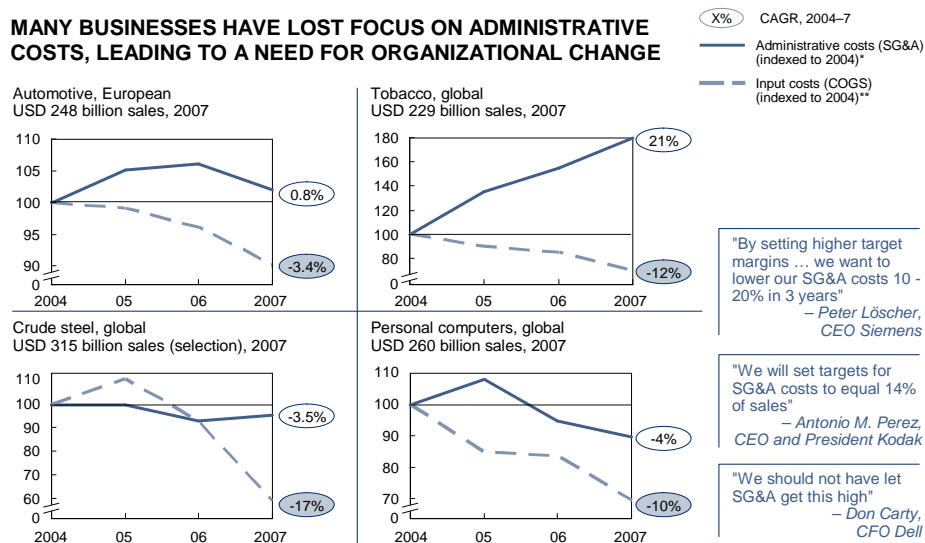


However, in whatever way the global economy develops, many public sector organizations will need to rapidly reduce costs and may often need to restructure their businesses – a daunting prospect under normal conditions, magnified by today's roller coaster-like environment.

We know that in all sectors, managing costs during growth is challenging. Many private sector companies have allowed administrative costs to increase over the last few years and now urgently need to address this (Exhibit 2). As government looks to identify how to address the challenges of the downturn, it will similarly need to identify the areas where there is greatest potential to reduce cost – and find ways to bring it down quickly.

Exhibit 2: The opportunity to reduce costs

MANY BUSINESSES HAVE LOST FOCUS ON ADMINISTRATIVE COSTS, LEADING TO A NEED FOR ORGANIZATIONAL CHANGE



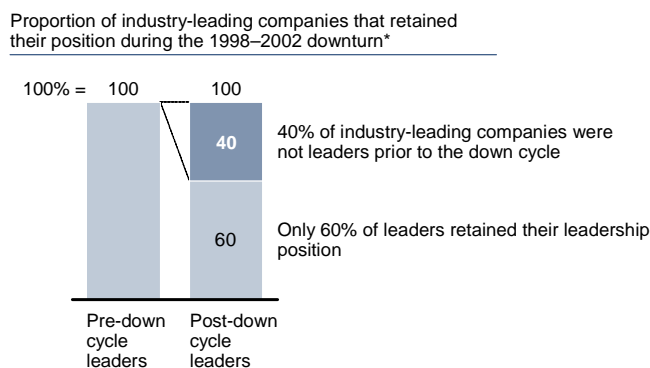
* SG&A (selling, general and administrative expenses) – i.e., including head office costs

** COGS (cost of goods sold) plus R&D cost/sales price – i.e., product cost relative to customer value

But however gloomy the outlook, we believe that this is also an opportunity to rethink the way in which work is done in the public sector. Major discontinuities are known to drive step change improvements in the private sector, and to reward companies that adapt to a changing economic context, by creating new capabilities and taking advantage of new opportunities. In milder recessions, industry challengers have used the downturn as an opportunity to replace more than 40 percent of industry-leading companies, and have then gone on to maintain their new positions over time (Exhibit 3). We believe that this thinking also applies to the public sector.

Exhibit 3: Major discontinuities create opportunities

ONLY 60% OF COMPANIES IN THE TOP QUARTILE IN THEIR INDUSTRY BEFORE THE 1998–2002 DOWN CYCLE RETAINED THEIR LEADERSHIP POSITION AFTERWARDS



* Pre-down cycle ranking based on 1998 and 1999, post-down cycle ranking on 2001 and 2002; evaluated change in position of 1,024 US industrial companies across 27 industries on basis of ROIC and market to book value
Source: Bloomberg, Datastream, Compustat

The current downturn is therefore an opportunity for governments to go beyond reducing headcount to change underlying activities. By taking this more fundamental approach, it will also be easier for them to sustain efficiencies over time.

In other words, now is the time to be bold:

- *Use this as an opportunity to rethink policy decisions and the way in which policy is delivered.* Is there an opportunity now to revisit changes that were not seen as possible before? Are some of the policy and delivery challenges of today also an opportunity to increase the overall effectiveness of the organization?
- *Are there opportunities to look again at all of the relationships that you hold?* Are there opportunities to work with others within government to consolidate back office functions or to renegotiate supplier arrangements?
- *Recreate your priorities and culture.* Do you want to build a more performance- or efficiency-oriented culture? Now is the time to address known areas of under-performance. Employees and other stakeholders are expecting change, so this is an opportunity to rewire the organization for the new environment before people refreeze around tired old practices and behaviors.

Some areas of government will proactively hit the challenges head on, taking a robust and fundamental look at their operating model and ways of doing business, and move the game on. They will energize their people around a transformation. Others will adopt an incremental approach that will make it hard, if not impossible, to drive the required transformation.

Those that choose to use the downturn as a platform for change will be the ones best positioned to deal with the fiscal and delivery challenges of the coming years. This paper addresses three steps that public sector organizations can take to give focus to their objectives and operating models, streamline their organizations, and build strength and agility in order to adapt to uncertain economic realities.

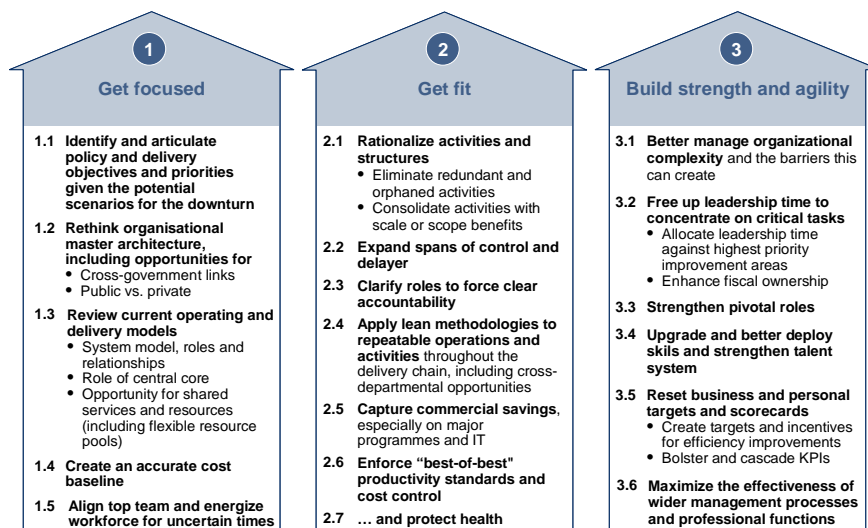
IDENTIFY THE MOST POWERFUL IMPROVEMENT LEVERS

In the heat of a fiscal crunch, it is tempting to take an incremental approach to reducing spend – top-slicing budgets and headcounts. But, however tempting, quick headcount reductions come at a price – they may run at cross purposes to more powerful changes (e.g. centralizing shared services or transforming system-wide relationships) and ignore the tradeoffs between cutting back in some parts of the organization and selectively building strength in others. Before embarking on a narrowly cast cost-reduction program, it is wise to consider fully three primary improvement levers (Exhibit 4):

- **Get focused.** What are the agreed or likely policy responses to the downturn, and how will the organization need to change to deliver these? Are there opportunities to restructure your organization, delivery model and system-wide relationships to better meet current and projected demands? Are there new challenges you need to address?
- **Get fit.** Streamline the organization and its delivery chain. Seven proven steps can quickly yield 20 to 35 percent or more savings in running costs. If done thoughtfully and in a coordinated fashion, these steps can improve the health of the organization at the same time as improving efficiency.
- **Build strength and agility.** The most overlooked opportunity in the heat of a crisis is to invest, selectively, in improving the effectiveness of key functions (e.g., procurement, operational improvement) to allow the organization to respond to new delivery challenges and enhance effectiveness over time. In addition, many organizations can benefit greatly from targeted investments to strengthen pivotal roles and functions.

We believe that each of these levers is even more important in the context of the economic downturn. As we set out later in this paper, each of these levers can be applied at speed by using a set of tried-and-tested tools, and learning from the defining characteristics of successful change programs across sectors.

Exhibit 4: Potential actions to deliver improvement

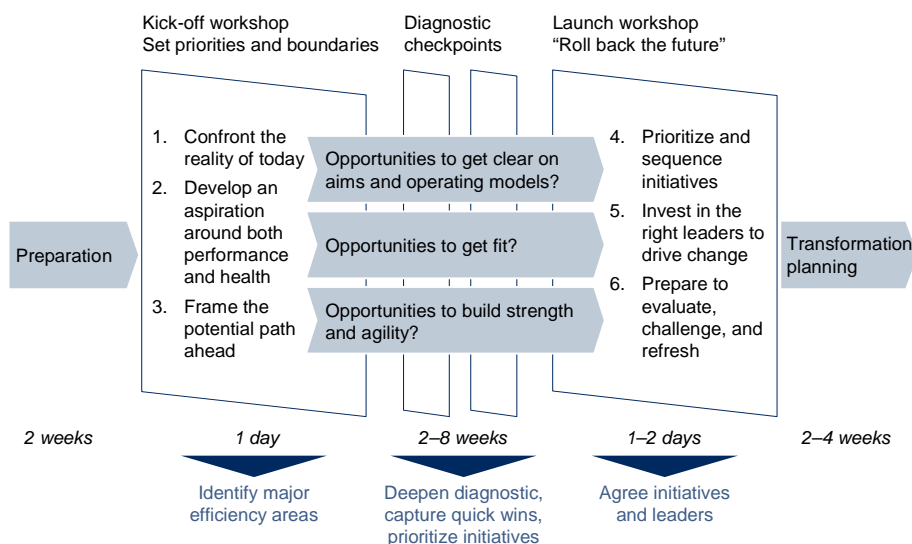


ALIGN ON PRIORITIES AND BOUNDARIES

Yes, there are three broad areas of potential improvements – but which are the most important and the most urgent? Do you have the time and resources to pursue every opportunity?

We suggest using a three-step process that first quickly focuses the organization on the most valuable and most urgent opportunities, next launches diagnostic and improvement teams, and finally designs a comprehensive transformation program with a prioritized and sequenced set of initiatives (Exhibit 5).

Exhibit 5: Start by aligning the top team on the nature of the challenge and potential opportunities



The start of this process is a kick-off workshop that aligns the top team on priorities and boundaries. Get the facts on the table and discuss their implications:

- *Policy responses.* What are the major policy responses, already agreed or likely, in response to the downturn?
- *Severity of financial situation.* What level of savings will be required to meet restrictions in government spending and what savings have already been identified?
- *Efficiency targets.* What guidance should teams receive? How much do they need to generate and in what time frame?
- *Likely sources of efficiency improvement.* Which areas do the team judge to be most promising and what are their boundaries?
- *Resourcing.* Given the size of the challenge, who are the right leaders to pursue the program and initiatives, and what support do they need?

This initial alignment is meant to identify opportunities, not to solve the problem completely. Success is a top team aligned on the mandate for change, with crystal-clear point responsibility for the initiatives that it is agreed are most likely to have impact.

Depending on the complexity of the situation this alignment should take from as little as a few days up to two weeks at most. Many organizations have found that scheduling a top team workshop one to two weeks after the outset applies productive pressure that quickly cuts through analysis paralysis and difficulties reaching agreement on direction and

resourcing. Executed well, such workshops create engaged leadership, which in turn builds the organizational buy-in required for successful and rapid opportunity capture.

Properly scoped diagnostic teams then investigate potential opportunities in greater depth and identify both impact potential and implementation feasibility. This step typically takes six to eight weeks, but the timing can vary depending on the scale of the organization and the resources used. Exhibit 6 describes how one public sector organization has applied this thinking.

Exhibit 6: G7 national government employment agency

RATIONALIZED NATIONAL, REGIONAL AND LOCAL ORGANIZATION STRUCTURE, SUPPORTED BY A NEW PERFORMANCE CULTURE

Situation and approach	Impact
<ul style="list-style-type: none"> • High unemployment #1 political issue in the country <ul style="list-style-type: none"> – Intense pressure to improve outcomes and reduce cost in the face of sustained high unemployment – Rising program and administrative costs, with significant variation in performance and costs across offices – 90,000 employees, working in highly complex structures with unclear boundaries between different layers of the organization – Lack of external confidence in the agencies • Comprehensive performance transformation initiative starting from an in-depth diagnostic <ul style="list-style-type: none"> – Initial diagnostic by central, co-located team identified principal improvement levers over six months – Responsibility for delivery devolved to local agencies through an extensive network of change agents 	<ul style="list-style-type: none"> • Fundamental redesign of the organization <ul style="list-style-type: none"> – Head office head count reduced from 1,200 to 400 – Clarification and significant redesign of the roles of the head office, regional offices and local agencies • Introduction of new performance culture and a new local business system <ul style="list-style-type: none"> – New KPIs and target-oriented management processes at every level of the organisation, linking policy objectives to local office performance – Systematic customer channeling and specialization in local agencies, reflecting differing customer needs – Systematic differentiated counseling of customers: program spend on labor-market integration allocated on the basis of customer characteristics and standardized action plans – Investment in capability building – managerial and frontline • Delivery of rapid operational improvements <ul style="list-style-type: none"> – >\$10 billion in annual savings through better allocation of program spend – Reduction in waiting times by 40% in six weeks in pilot, with waiting time largely eliminated in subsequent years – Amount of quality counseling time in reorganized offices doubled in two weeks

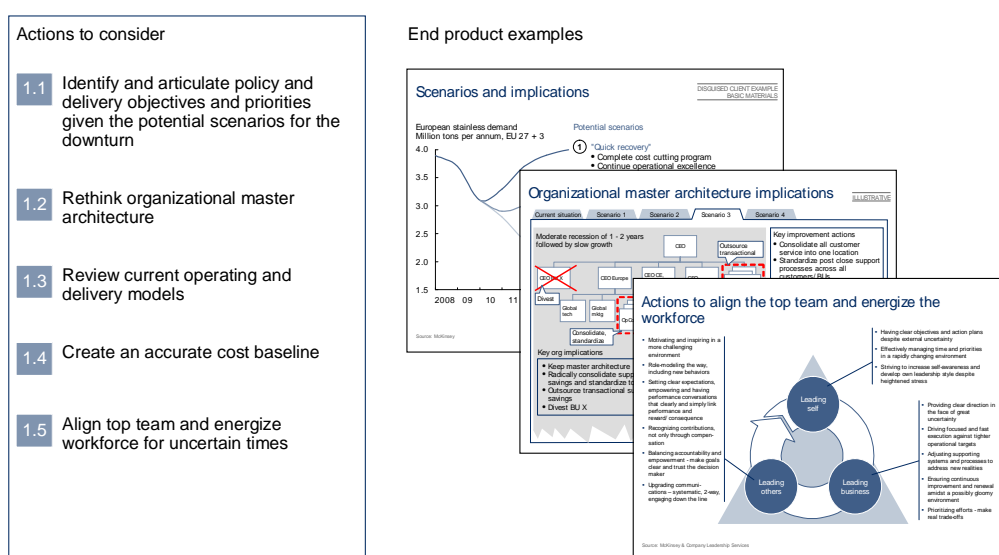
Different organizations will use different combinations of the levers described here. For some, business restructuring (e.g. transfers of functions, creation of shared service centers) will play a major role. Given the financial environment, many will also find large opportunities in procurement, or opportunities to enhance capabilities to meet new challenges. There is no single right answer, so take the time to think through how many diagnostic and improvement teams you really need and how they should be scoped.

LAUNCH DIAGNOSTIC AND IMPROVEMENT TEAMS

Depending on the situation you will likely launch teams that will identify improvement opportunities in three areas. For each of these areas a core set of questions needs to be addressed. In each case we have developed a set of tools to support systematic, objective analysis and decision-making on choices and trade-offs.

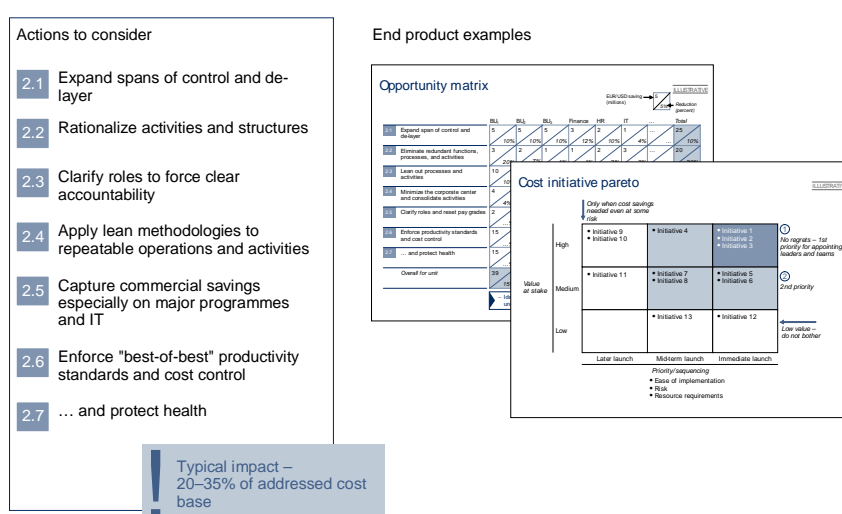
- *Get focused – align your policy and operating model* (Exhibit 7). Your most thoughtful leaders should head these efforts, including up-and-comers who in time will take on senior roles in the organization. They should address a set of critical questions in determining the strategic direction of the organization:
 - Mandate creativity: what are the sources of policy innovation?
 - What is the “master architecture” of the organization under not one but multiple future scenarios? Are there any no-regrets restructuring moves? Are there trigger points for potential moves that depend on economic conditions?
 - What changes could be made to wider roles and relationships across your delivery agencies or wider organizations at different tiers of government, or in the private or nonprofit sectors?
 - What is the baseline for costs across the organization?
 - Is there a shared set of aspirations, and a common understanding of the opportunities, challenges and choices to be made, across your leadership team? How has this been communicated across your workforce?

Exhibit 7: Get focused – align your policy and operating model



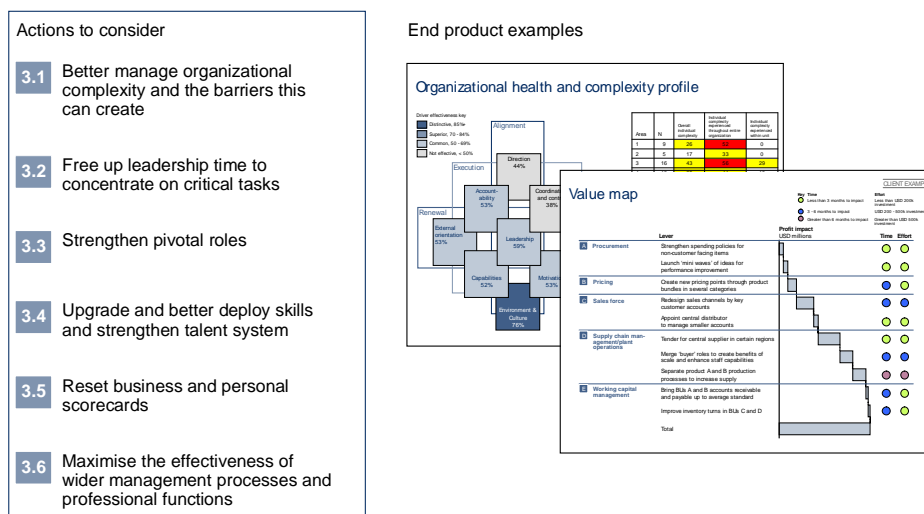
- *Get fit – streamline the organization* (Exhibit 8). Building from an accurate cost baseline, ask your teams to create an “opportunity matrix” that summarizes potential savings against this baseline. Ask for detail on the source (e.g., layering vs. centralization) and where in the organization costs will be saved. Have them create a “cost pareto” that prioritizes potential cost initiatives by improvement potential at stake and ease of capture, keeping also in mind the effects that each one will have on overall organizational health.
- Where can efficiencies be created by de-layering the organization?
- Can organizational structures and activities be rationalized – whether through prioritizing essential activities, consolidating activities with scale or scope benefits, or creating a more streamlined but effective corporate centre?
- What changes are needed to ensure clear accountabilities?
- What benefits to efficiency, effectiveness and customer service can be delivered through lean transformation? Where existing programs are in place, have the full benefits been captured?
- What efficiencies can be obtained in external spend? Where can an enhanced commercial relationship support delivery of major programs?
- What approach to performance management will ensure that near-term efficiency gains are captured, with transparency on costs and performance?
- What actions are needed to ensure that efficiency gains do not compromise the core capabilities and assets that are essential to long-term delivery?

Exhibit 8: Get fit – across the entire organization



- **Build strength and agility – selectively** (Exhibit 9). This diagnostic, the most challenging, requires both an assessment of “hard” economic impact from improving key functions like procurement, and a more qualitative assessment of how steps that remove bottlenecks from decision-making can improve broader organizational effectiveness. These diagnostics are often led by senior leaders, with extensive HR support.
 - Where can decision-making or delivery be enhanced by removing barriers that result from the need to work across complex organizations or to involve wide numbers of stakeholders?
 - If you started from a fresh sheet, how would you allocate leadership time against your top priorities, i.e. those decisions or interventions that just cannot be delegated?
 - What changes are needed to ensure that leaders in pivotal roles – whether relating to policy, professional functions or delivery – have the skills, decision rights and the levers of influence they need?
 - How do you ensure that you have the skills you need where you need them, and a sustainable model for growing, retaining and deploying talent? What new or additional skills could you access or develop?
 - Which targets – qualitative and quantitative – will ensure that your organizational priorities flow down to a unit and individual level? Which metrics are most important to the organization’s performance and health?
 - How far are you on your journey to embed best-in-class management and professional functions, e.g. in finance, procurement and IT?

Exhibit 9: Build strength and agility – selectively – through targeted actions to de-bottleneck and increase effectiveness



PRIORITIZING YOUR CHANGE INITIATIVES

Teams can assess the areas above in about six to eight weeks. At the end of this time the organization will be able to take some initial decisions, and will have a comprehensive, prioritized set of initiatives that maximizes near-term impact and optimizes the future state.

However, for this type of program to be successful it will be important for the leadership team to be aligned around a series of challenging questions:

- *How will we integrate new initiatives into existing change programs, and which do we prioritize?*
- *How will we reconcile competing demands for resources from various improvement teams?*
- *How will we sequence initiatives to both capture impact from quick no-regrets actions and preserve improvement from long-term structural changes?*

In our experience, your best bet is to convene your top team, along with the leaders who investigated each improvement lever, in a multi-day workshop to “roll back the future” and address these issues (Exhibit 10).

Such programs usually only deliver what they are able to measure, so the output of this workshop should be a clear action plan with targets that can be used as benchmarks.

Exhibit 10: A launch workshop aligns the top team on the actions and trade-offs necessary to unlock the three improvement levers

- | | |
|--|---|
| <p>① <u>Picture the future and implications, by scenario, for how you can best achieve your objectives</u></p> | <ul style="list-style-type: none"> • How might the overall economy and the organisation's role evolve (scenarios)? • What are the major policy responses, already agreed or likely, in response to the downturn? • What unique opportunities to rethink our delivery model might we have by scenario? • What risks must we guard against? • What organizational and delivery models should we aim for? • What are the implications for cost cutting – how much must we lean out and where? Where should we <i>not</i> make cuts? • What are the implications for areas where we should invest to build strength and agility – what capabilities will be core to future success? |
| <p>② <u>Understand opportunities and trade-offs to get fit and build strength and agility</u></p> | <ul style="list-style-type: none"> • What is the slate of opportunities to reduce cost in the organization (cost Pareto)? <ul style="list-style-type: none"> – Impact/risk? – Ease of implementation? – Timing/sequencing requirements? – Fit with scenarios/new organizational and delivery models? • Are there attractive opportunities to invest in to build institutional strength and agility? <ul style="list-style-type: none"> – Impact/risk? – Ease of implementation? – Timing/sequencing requirements? – Fit with scenarios/new organizational and delivery models? • What's the master list of potential initiatives, eliminating overlapping and inconsistent initiatives? |
| <p>③ <u>Prioritize and sequence improvement initiatives</u></p> | <ul style="list-style-type: none"> • Are there no-regrets steps that should be taken immediately? • How should other potential initiatives be prioritized, e.g., <ul style="list-style-type: none"> – Timing/magnitude of cost reduction (now vs. in 6 months vs. next year)? – Support of potential structural moves? • What specific initiatives should be launched now vs. in 6 months vs. next year? <ul style="list-style-type: none"> – How should they be staffed? – What performance targets will these initiatives achieve? By when? – How will these be built into the budget? – How should they be integrated into existing change programs and initiatives? • What other current initiatives should be re-scoped to meet new challenges or fund priority initiatives? |

Roll back the future

LEARN FROM OTHERS

We have talked about a variety of ways to find opportunities in the economic downturn. But before launching any restructuring journey, leaders should carefully reflect on lessons from others who have taken this path before. It is difficult to make transformation programs succeed: many surveys, including our own, put the success rate at less than 40 percent.¹ Our recent research on what makes transformation programs succeed, however, underscores the fact that a set of specific tactics promote successful outcomes.²

- *Be aspirational.* Programs founded solely on fear rarely lead to long-term success. Motivate your employees with *both* a clear, compelling view of the future (a “North Star” to guide the way) *and* aggressive cost reduction and performance improvement targets (a “burning platform”). In our research, 56 percent of transformations where well-defined stretch targets were established succeeded, vs. 21 percent where they were not.
- *Assemble a winning team.* It’s all too easy to delegate leadership of performance improvement teams to second-tier managers, on the rationale that the most capable are needed to run the organization. This is a recipe for mediocre results. Think of the scale of opportunity and change; hook up your strongest horses to the biggest ploughs.
- *Lead from the top.* Personal leadership sets the agenda as a priority for the organization and maintains momentum. Force objectivity by insisting on facts vs. opinions, and ensuring brutal honesty. Ask tough probing questions and maintain the pressure to deliver more: *What are the benchmarks? What do staff and stakeholders say? What would happen if we were more ambitious in the depth or speed of change? What roadblocks need to be removed to get this done?* Transformations with strong CEO involvement were more than twice as likely to succeed (a 49 percent success rate vs. 24 percent without).
- *Engage the front line.* Ensure that the changes are understood and owned throughout the organization or delivery chain – right down to the front line. Programs which ensured frontline ownership of change were 71 percent more likely to succeed than those without.

¹ For example, see “*Organizing for successful change management: A McKinsey Global Survey*,” July 2006; and “*Creating organizational transformations: McKinsey Global Survey Results*,” August 2008, both available on www.mckinseyquarterly.com.

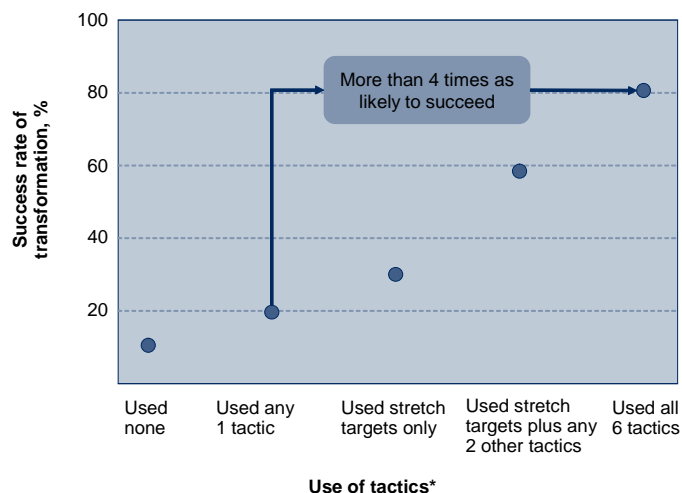
² See “*Voices on transformation – Insights from business leaders on how to manage successful change*,” March 2009. Research from 2008 McKinsey global survey on performance transformation comprising responses from 2,994 executives with recent transformation experience.

- *Align mindsets and behaviors.* What kind of culture are you trying to build? Communicating this isn't enough. Make sure you reinforce with the right measures and incentives and get your management team to proactively role model and reward the behaviors you want.
- *Don't get lost in the short term and maintain a positive slant.* Even if conditions demand a strong focus on near-term performance, find a way to emphasize at least one investment to build new areas of capability, in order to provide the organization with a positive outlook for the future. Balancing positive and negative messages increased the chance of success by more than a third. Make sure senior management maintains long-term focus, rather than shifting to other initiatives. Sequence initiatives over time, depending on their impact.

Each of these factors is important on its own. In combination, they have the potential to radically improve the chances of success. Those change programs that used all six identified change tactics were four times as likely to be successful as those that only used one (Exhibit 11).

Exhibit 11: Using multiple tactics radically improves chance of success

Share of transformations described as extremely/ very successful, % of respondents, n = 2,994



* The six tactics in this survey were: establishing well-defined stretch targets; assuring strong CEO involvement; organizing a clear structure for change; ensuring frontline ownership of change; implementing an equal mix of positive and negative messages; and launching a large-scale, collaborative planning effort
Source: "Voices on transformation – Insights from business leaders on how to manage successful change," March 2009. Research from 2008 McKinsey global survey on performance transformation comprising responses from 2,994 executives with recent transformation experience.

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As the current economic situation plays out, different organizations – in the private and the public sector – will take different approaches to grappling with the challenges it creates. There is, however, a real opportunity to use the downturn to create a step change both in efficiency and in outcomes.

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