

# Toward a more efficient public sector

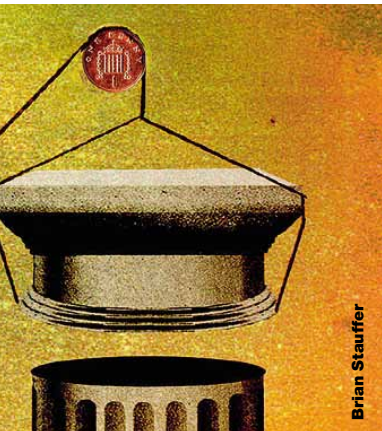
**As they undertake efficiency programs, government leaders should take four actions to ensure their efforts are effective and sustainable.**

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Many governments around the world face a once-in-a-generation need to significantly reduce their expenditure. Views differ on the speed with which governments must respond to the economic crisis, but a number of governments have already announced plans to capture savings that are unprecedented in their countries' recent history. In the United Kingdom, government departments have recently been given savings targets of up to 40 percent, with all departments required to reduce headquarters costs by 33 percent. Government-wide efficiency programs are also in place in other countries including Canada, France, Greece, and Spain. Even those governments not currently facing major efficiency drives are increasingly considering how to do more with less.

To be sure, efficiency savings alone are insufficient to solve the deficit challenges, but they will undoubtedly play a critical role. This article highlights four actions for government leaders who choose to pursue a far-reaching and sustainable approach to efficiency-led transformation. It draws on experience from governments worldwide that have undertaken efficiency programs. It also draws on lessons from the private sector, where productivity and associated notions—such as continuous improvement, innovation, and scale—have long been part of the management lexicon.

We recognize that there are important differences between the public and private sectors. Government leaders face challenges—including



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legislative constraints, organizational complexity, and public scrutiny—that are rarely evident to a similar extent in the private sector. As recent public protests in many countries across Europe have indicated, every government efficiency program will almost certainly encounter opposition from the public and other stakeholders. Yet tough times can create the impetus for previously unthinkable transformations in the public sector. In the United States, the New Deal in the 1930s introduced big changes that have stood the test of time: among them, the Social Security Act, the Securities and Exchange Commission, and the Federal Housing Administration. The United Kingdom created the National Health Service (NHS) during the austere years following World War II. It was in the wake of Sweden's economic and banking crisis of the 1990s that the Swedish government created momentum for major reforms in health care, education, and beyond.

To achieve such radical transformations, political leaders and senior officials must create the will and vision for deep-rooted change. Without such a vision, any efficiency program will be regarded as a cost-cutting exercise, rather than as a renewal of public services that can engage employees at all levels of the organization. The German Federal Labor Agency, which in 2003 embarked on a major transformation program in the face of persistently high unemployment, showed how an agency can use a crisis as a catalyst to create something new and better. A new, more focused mission statement was at the heart of the transformation and directly fed into a new set of priorities, focused targets, streamlined corporate functions, and an entirely new organization model, which affected all 90,000 of its employees.

In the face of both enormous efficiency pressures and barriers to change, we believe government

leaders will benefit from considering the following four actions.

### **1. Work out what really matters—and stop everything else**

Delivering major efficiency savings requires rethinking and reprioritizing all areas of activity—and, most important, making active decisions on what to stop doing. A sign of intelligent cost reduction—as opposed to reactive slashing—is that costs are not cut uniformly across the board.

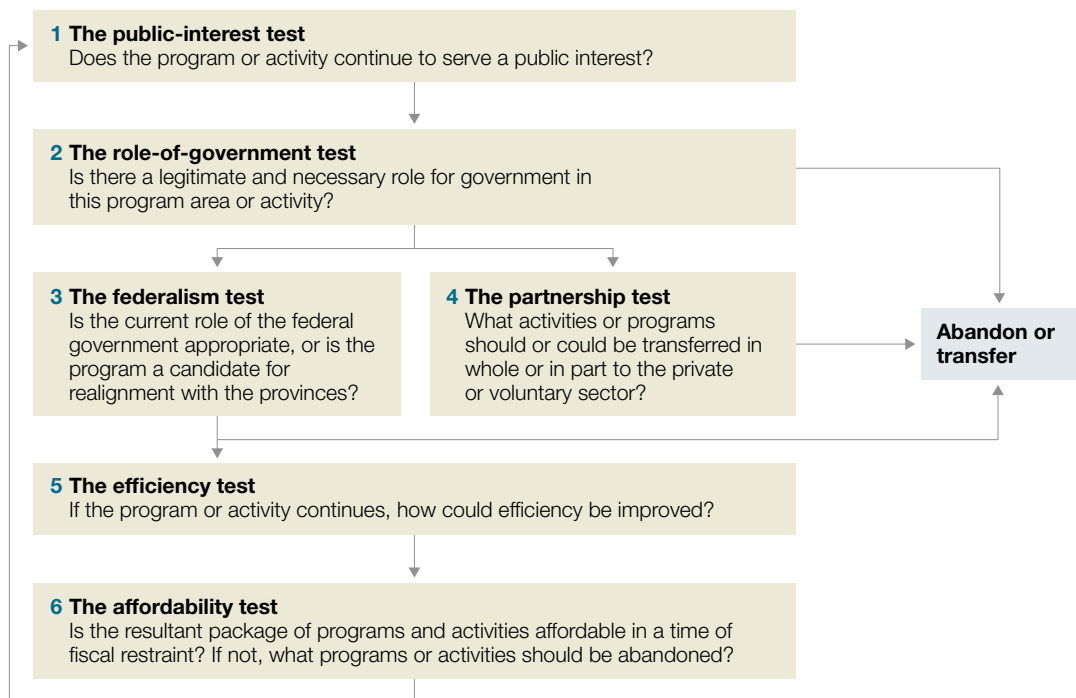
Private-sector companies that respond effectively to financial downturns quickly identify the businesses, products, and capital programs they want to maintain, those they need to rein in or stop, and those in which they want to invest. They proactively prune their portfolio, allowing favored priorities to flourish. In the public sector, a more nuanced approach is needed, since there are many activities that the government must continue because of legislation or for reasons of fairness; governments also lack the flexibility of a business, which can simply decide to stop serving an expensive-to-reach segment of the population. However, these constraints should not prevent a detailed review of expenditure.

The primary aim of Canada's Program Review of 1994–95, a major government transformation effort, was to reduce the country's deficit by reducing expenditure. The Canadian government used six criteria to review each spending program (exhibit). The review led to the elimination of a number of activities (for example, agriculture and transport subsidies) and radical changes in how certain services were delivered (including privatization of air navigation).

In undertaking such a review, leaders should force objectivity, insisting on facts rather than opinions and valuing brutal honesty. To help

## Exhibit

## Canada's Program Review used six criteria to help reduce expenditure.



Source: Jocelyne Bourgon, *Program review: The Government of Canada's experience eliminating the deficit, 1994–1999—A Canadian case study*, The Centre for International Governance Innovation, September 2009

ensure that they understand trade-offs and make the best decisions, they should seek to develop a robust fact base that provides a clear view of the costs—as well as the cost drivers—of each initiative and program. Ideally there should also be a clear understanding of the effectiveness of different interventions. External benchmarks can be helpful in this regard: for example, recent research that lays out the cost and effectiveness of various interventions for reducing greenhouse gas emissions has helped governments prioritize environmental interventions.<sup>1</sup>

Of course, eliminating services or activities is politically sensitive and thus difficult for

governments. It requires close collaboration between political leaders and officials, a clear set of policy priorities and decision criteria, an explicit decision-making process at the ministerial or even national level, and a thoughtful communications plan for the public.

### 2. Shake up and clarify roles and relationships

A refocused set of activities is likely to require new organizational arrangements—new structures, roles, relationships, and linkages within and among all the organizations involved in policy making, funding, delivering services, or managing performance.

<sup>1</sup> “Pathways to a low-carbon economy: Version 2 of the global greenhouse gas abatement cost curve,” January 2009; and “Impact of the financial crisis on carbon economics: Version 2.1 of the global greenhouse gas abatement cost curve,” August 2010, McKinsey & Company.

Large-scale organizational changes in government are typically beyond the remit of individual senior leaders. Indeed, in some countries, the organizational landscape is regarded as untouchable and outside the scope of any review. However, explicitly discussing the efficiency benefits of organizational changes, where they are possible, can be enormously valuable. For example, in a local government context this might involve distinguishing between “democratic” units (in which elected members of a local authority make decisions affecting a local area) and “operational” units (in which neighboring authorities may choose to benefit from economies of scale by combining certain back-office functions, such as procurement, or frontline services, such as garbage collection).

A good starting point is to take a clean-sheet approach: with no legacy, what would be the ideal set of organizations to deliver the revised priorities, and how would they work together? Organizational arrangements should then be reviewed at multiple levels:

**At the center.** Governments and agencies should be thoughtful about the size and role of the center. Global private-sector organizations often have strategic centers that are relatively small: GE’s corporate center of about 550 people runs a business with more than 300,000 full-time-equivalent (FTE) employees; Johnson & Johnson has more than 100,000 FTEs, and its center consists of approximately 1,000 people. Such small centers are less common in the public sector, but they are certainly feasible. As part of its recent reform program, for example, the German Federal Labor Agency reduced head count at its headquarters from 1,200 to 400.

The size of the center will depend on its role, and what is right for one country may not be right

for another. In the Swedish government’s efficiency drive in the 1990s, the center of government set cost-reduction requirements, leaving individual agencies to identify and deliver these reductions. By contrast, France has constructed its reforms as a single integrated program (see “A duty to modernize’: Reforming the French civil service,” p. 12). Regardless of the approach, the center of government or of a major agency has a unique role in setting objectives, determining where change should be centralized or devolved, clarifying accountabilities, and identifying the capabilities and incentives needed to make change happen. Activities beyond these are likely to be worth reviewing.

**Across areas of public services.** Delivery of public services often involves a complex system of multiple organizations including policy makers, regulators, payors, and providers. Adjusting these relationships can be a major driver of efficiency. For example, in an approach that drew on lessons from charter schools in Sweden and the United States as well as independent not-for-profit hospital models in other countries, England’s NHS conferred “foundation trust” status to higher-performing hospitals, gave them greater independence, and increased the participation of staff, patients, and the public in their governance. Since their creation, foundation trusts’ financial performance has been significantly better than that of other hospitals. At the same time, a statute established a new independent regulator, Monitor, to assess whether hospitals should be given foundation-trust status, regulate the performance of foundation trusts, and develop their leadership and managerial capabilities.

**Among the public, nonprofit, and private sectors.** Transferring activities from the public sector to the private or nonprofit sector has been a valuable source of savings in some countries: it was an

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important part of the New Zealand reforms between 1984 and 1991 and the Canadian Program Review, for example. The current UK government has made it a priority to have more public services (such as support for children with special needs) delivered by nonprofits.

In making any of these types of organizational changes, governments should focus on capturing benefits—be it in the form of reduced overlaps, greater expertise, improved responsiveness, streamlined processes, or better outcomes for citizens. Otherwise the changes will merely shift responsibilities from one entity to another without creating benefits for efficiency or outcomes.

### 3. Relentlessly drive out costs

Once governments have developed a vision, prioritized activities, and worked out the organizational landscape to deliver them, the focus must turn to driving out costs. Public-sector leaders must take the following steps:

#### [Scour the landscape for the largest opportunities.](#)

Many organizations dive into only a few high-value areas (such as increasing the efficiency of existing operational processes) and overlook other opportunities, thus risking leaving substantial savings on the table. Instead, they should take a broad perspective and systematically look at all levers, considering savings potential, feasibility of delivery, and impact on wider policy objectives and economic growth. For example, the 2010 UK Spending Review looked in parallel at tax rates and tax compliance, social-security

benefits, and administrative, program, and capital spending. Taking a broad perspective will help identify new opportunities: for example, few governments today have implemented the private sector’s best practices in procurement, despite the fact that procurement typically represents about 30 percent of the expenditure of governments in Organisation for Economic Co-operation and Development countries (excluding transfer payments such as social-security payments).<sup>2</sup>

[Seek scale where it matters.](#) To gain economies of scale, public-sector bodies have mandated consolidation and standardization in procurement and IT, established shared-service centers across government departments, and aggregated local services in regional clusters. Some governments have established multforce police air support bureaus, for instance. Others, such as Denmark and, more recently, the United Kingdom, have centralized significant areas of procurement to achieve major savings. The complexity and size of the public sector mean that significant opportunities remain for improvements of this type, but they are harder to deliver than in many corporate settings. Clear communications about the benefits of the changes—especially to members of the public who may have lost a “local” provider—are crucial to success.

[Simplify and streamline where scale does not matter.](#) Governments have become more efficient by applying lean methodologies, though improvement opportunities remain in many areas. Lean techniques have been successfully applied to repeatable processes in areas as diverse as tax

<sup>2</sup> See Christian Husted and Nicolas Reinecke, “Improving public-sector purchasing,” *McKinsey on Government*, Summer 2009.

processing, defense logistics, health care, and court services. Applying a lean approach to policy making in a European government led to the development of a new policy-making approach and flexible resourcing model. Importantly, our experience is that efficiency and effectiveness go hand in hand: rather than forcing a trade-off, lean transformations can improve citizen outcomes, customer service, and job satisfaction while reducing costs.<sup>3</sup>

Streamlining can deliver many times the impact if implemented at scale. One way to scale up is to establish a departmental or government-wide academy for building internal capabilities for continuous improvement. The NHS Institute for Innovation and Improvement has taken an alternative approach: its Productive Ward program gives hospital staff the tools they need to apply lean techniques themselves, requiring only limited support from a trained facilitator. To date, the program has led to more time spent on patient care, increased patient satisfaction, and significant efficiency gains in certain processes.

#### **4. Model the leadership style and substance you want—and invest in strengthening the organization for the long term**

In our experience, leaders often overlook the “soft” elements—the culture, capabilities, people, and processes—that allow efficiencies to stick and that make the impact sustainable. To avoid an efficiency drive that ultimately results in a weaker, lower-performing organization, leaders must define the culture and values of the future organization and let these inform the aspirations,

themes, and tone of the transformation. They must identify the pivotal roles and crucial people, ensure that high-potential individuals remain committed to the organization during periods of upheaval and uncertainty, and develop a plan for matching the right people to critical roles. They must engage the best team—senior leaders, big thinkers, opinion shapers, and leaders of the future—to take collective ownership of the transformation effort. And they must keep close tabs on the organization’s morale: it is not unusual for morale to dip at first, but it should recover quickly—and even rise to a higher level than the starting point.

The way an efficiency program is led is just as important as a program’s technical aspects. Therefore, government leaders—politicians and career officials alike—must devote significant amounts of their personal time, as well as their organizational and political capital, to leading change. Efficiency programs present a significant opportunity to invest in the new organization and build the skills of a new cadre of senior leaders and frontline staff, on whom the delivery of future government services will depend.



The public-expenditure crises facing many countries should serve as a call to action for government leaders. As well as pursuing savings relentlessly, they should build a positive story around efficiency, seek out the next ground-breaking flagship policy, and invest in building the government department or agency of the future. It may be the best chance for a generation. ○

<sup>3</sup> See Maia Hansen and John Stoner, “A leaner public sector,” *McKinsey on Government*, Summer 2009.