

Global trends affecting the public sector

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The public sector faces a decade of radical and ongoing change. It will be shaped by ten global trends that are affecting governments and companies around the world. These trends — macroeconomic, social and environmental, and business — will not only determine new policies, but also a transformation in the way that governments and agencies are led and managed.

In the past year, McKinsey has set out ten global trends that will impact society, and by extension business and the public sector, over the next ten years.¹ We believe there are five main implications for the public sector: governments must radically increase the productivity of public services; change their relationship with citizens to address their ever increasing demands; redraw their organizational landscape to deliver better services; achieve a major cultural change that puts data at the heart of policymak-

ing and management practice; and find new ways to compete against the private sector to attract and retain scarce talent.

The nature and scale of these trends make the coming decade a defining period for the public sector. Developing a reform agenda in response to these trends will require an increasing integration of political and managerial agendas for reform. It will require extraordinary leadership from both politicians and civil servants.

¹ See *McKinsey Quarterly* articles by Ian Davis and Elizabeth Stephenson, “Ten Trends to Watch in 2006,” web exclusive, January 2006; Wendy M. Becker and Vanessa M. Freeman, “Going from Global Trends to Corporate Strategy,” 2006, Number 3; “An Executive Take on the Top Business Trends: A McKinsey Global Survey,” web exclusive, April 2006. Articles available at www.mckinseyquarterly.com

THE TEN GLOBAL TRENDS

Macroeconomic

1. Centers of economic activity are shifting, both regionally and globally. The proportion of world GDP that comes from Asia (excluding Japan) is set to increase from 13 percent today to 22 percent in 20 years, with China's economy second only to the United States in size. Among developed economies, rates of growth will vary widely, between countries and industries. As a result, key parameters shaping the economic policy of developed and emerging economies will change.

2. Demands on public-sector spending are rising dramatically. The unprecedented aging of populations across developed economies will lead to unsustainable increases in pension and health-care budgets. In emerging markets, people will demand greater state-funded protections, such as health care and retirement security.

3. New consumer groups, with new needs and behaviors, are developing. Rising incomes in emerging markets will add almost a billion new consumers to the global marketplace in the next decade. In developed economies, consumer profiles will change as the numbers of single households, households with working women, and wealthier households grow. Across both developed and emerging economies, people expect their governments to deliver better services.

Social and environmental

4. Technology is transforming how we live and interact. Developments in IT and other technologies will transform both the way that organizations work, and the way that people interact with government, business, and each other. Norms of slow, distant, paper-based communications with government departments will increasingly be replaced with interactions that are rapid, personalized, and electronic. Citizens will access and share data on their governments as never before.

5. Rising tides of people will be on the move. Greater migration of skilled and unskilled labor will place new demands on both receiving and sending countries. In developed and emerging economies, organizations in the public and private sectors will need to address shortages of skills and access new pools of labor.

6. The social tradeoffs of the free market are coming under greater scrutiny. Governments and business are facing increasing pressure to deal with issues of social welfare and equity — whether domestically or on global issues such as public health or poverty. The agendas of government, business, and nonprofit organizations will become more aligned in tackling these issues.

7. Demand for natural resources is growing, as is the strain on the environment. Developed and developing countries alike are using natural resources at unprecedented rates. Resulting problems — such as climate change — require immediate, dramatic shifts in behavior. Innovation in technology, regulation, and the use of resources will be essential for balancing robust economic growth and a sustainable environment.

Business

8. Industry structures are rapidly changing. Across sectors, traditional organizational boundaries are being redrawn. Productivity gains are being achieved by organizations with global scale, niche expertise, or the adaptability to work with flexible networks of suppliers, producers, and consumers. The conventional organization of government departments — characterized by large, siloed departments of state — is increasingly removed from private sector best practice.

9. Management is adopting data-driven techniques and mindsets. Greater scale and complexity demand new tools to run and manage organizations. Improved technology and statistical tools have given rise to new management approaches. These approaches underpin the performance of leading organizations, whether public, private, or nonprofit — but they are still rare in the public sector.

10. The economics of knowledge are changing. Successful organizations are those using, and investing in, new and more varied sources of knowledge — be it proprietary research from specialist providers, open-access online resources, or collaboratively produced knowledge. Public-sector organizations can draw much more systematically on internal and external best practice and benchmarks. By externalizing their knowledge, they can also better inform and engage citizens and business.

These trends will impact public and private sector alike. In addition, many governments will encounter enduring threats to domestic and international security, which will shape multiple areas of domestic and international public policy.

FIVE IMPLICATIONS FOR THE PUBLIC SECTOR

1. GOVERNMENTS MUST BE MORE PRODUCTIVE

The acute productivity imperative facing governments is simply put: governments are being asked to do more, do it better, and do it with the same amount of taxes.²

Aging populations in many countries will require governments to expand already overburdened health-care and retirement programs. The scale of this challenge dwarfs the numbers associated with almost any other sector of the economy. US government forecasts imply that on the basis of current policies, spending on public health-care and pension programs will double by 2040, resulting in a potential fiscal deficit of \$3 trillion — 26 percent of GDP.³

But governments also need to do the same things better. Public expectations are increasing, for better schools and health care, reduced crime, more effective immigration, and social services. In addition, there is a need to provide new services to support changing household structures and build new skills in the workforce in the face of globalization. As a result, governments will need to improve their effectiveness significantly, which means finding ever-more innovative ways to deliver better public services.

How will this be paid for? The choices are not attractive: few politicians want to increase taxes or reduce spending, although undoubtedly some combination of these measures will be required. Many therefore will need to achieve

enormous efficiency savings if they are to retain any degree of fiscal discipline. In the private sector, efficiency efforts have proved highly successful in industries such as banking, retail, and telecoms, where labor productivity in the United States — defined as output produced for every hour worked — increased by more than 50 percent from 1995 to 2003.⁴ In the public sector, such efforts are often seen as controversial, but in our experience efficiency and effectiveness often go hand in hand: initiatives to increase efficiency that are both successful and sustainable are typically those that improve effectiveness and outcomes at the same time.

As an example, the German Federal Labor Agency — the 90,000-person organization responsible for unemployment benefits and workforce integration — embarked on a transformation that reduced the overall spending on vocational training by 60 percent without losing impact; doubled the proportion of frontline staff members' time spent on counseling jobseekers (rather than on administration); and more than halved waiting times.

Achieving this scale of change requires multi-faceted reform programs. Organizations must be reformed so that they have effective strategic centers, fewer organizational layers, and more effective governance. Frontline operations should be transformed, challenging assumptions about the way things have been done in the past. Operating environments need to be reformed to provide the right mix of pressure and support to transform performance; for example, by fostering competition between providers (public, private, or nonprofit). Leaders will need to

² For more on public sector productivity, see Tony Danker, Thomas Dohrmann, Nancy Killefer, Lenny Mendonca, "How can American government meet its productivity challenge?" July 2006, www.mckinsey.com

³ "21st Century Challenges: Transforming Government to Meet Current and Emerging Challenges," Government Accountability Office (GAO), 2005, www.gao.gov

⁴ 60-Industry Database, Groningen Growth and Development Centre, September 2006, www.ggdc.net

be far more focused on managing performance, and on building the capabilities, alignment, and motivation of their employees. The political will and leadership talent required to achieve this will be immense.

Governments are being asked to do more, do it better, and do it with the same amount of taxes

As well as being a fiscal and social imperative, public-sector productivity is also an important element of governments' ability to increase the productivity of their economies. This is especially true in countries such as France and Sweden, where the public sector represents a large proportion of GDP. It will be equally important in developing economies, such as those in Africa, India and the Middle East, where more effective public sectors have a vital role to play in economic development and in alleviating poverty.

2. A NEW RELATIONSHIP BETWEEN GOVERNMENT AND THE CITIZEN IS NEEDED

The public is increasingly expecting public-sector services to be comparable to the best in the private sector. In the United Kingdom, for example, more than 50 percent of people expect access to the services they need in the evenings and on weekends.⁵ Across Europe, patients are demanding specific treatments not offered by their public health-care providers. Consequently, public sectors must build new kinds of relationships with their citizens.

Put people at the heart of public services. Many governments are already responding by providing greater access, choice and personalization of public services.

The state of California has set out an aspiration to provide 24/7 access to all government services through a single Internet portal. Similarly, across the European Union, the proportion of basic public services that is fully available online rose from 20 percent in 2001 to 52 percent in 2006.⁶ Education reform in Sweden has brought in new providers and offered much greater choice to parents. In the United Kingdom, the government is allowing people with long-term care needs to personalize their care, by giving them direct control over the way in which their allotted funds are spent across public, private and non-profit providers. Initiatives like these require a thorough and data-driven understanding of people's needs, circumstances, and preferences.

Increase public accountability.

Governments are facing more public and media scrutiny of decision making, spending, and performance — all of which leads to greater accountability. An unprecedented amount of information is available through the Internet, from data on the performance of hospitals in Norway and the United Kingdom, to minutes of cabinet sessions in Estonia that are made publicly available immediately after each meeting. The number of OECD countries with Freedom of Information legislation has risen from 5 to 29 (out of a total of 30) since 1970.⁷

Work with constituents by encouraging “co-production.” There is a whole range of issues where governments can achieve their objectives

⁵ “People's Panel Survey,” conducted by the UK Cabinet Office, 2000, <http://archive.cabinetoffice.gov.uk/service-first/2000/panel/wave4/summary.htm>

⁶ “Online Availability of Public Services: How is Europe Progressing?” Capgemini, June 2006, p.8

⁷ “Modernising Government,” OECD 2005; and German Federal Commissioner for Data Protection and Freedom of Information, http://www.bfdi.bund.de/cln_030/nn_672634/IFG/Gesetze/Gesetze_node.html_nnn=true

only if people change their behavior. To achieve that level of co-production, governments should look to behavioral science to develop innovative approaches that balance the use of mandates, incentives and measures that enable and inform citizens to take different decisions.

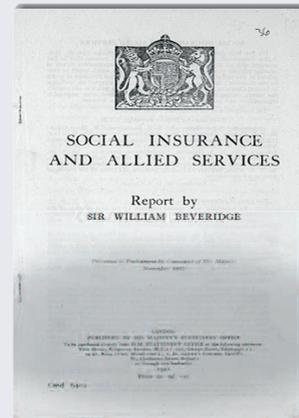
For example, encouraging more people to save for retirement will require not only some mandatory element and tax breaks but also financial education. Reducing carbon emissions will require not only regulatory changes and incentives, but also persuading people to make decisions that are economically rational but often overlooked because of force of habit or short-term cost considerations (an example being energy-efficient lightbulbs). In health care, governments will need to focus as systematically on prevention (that is, changing behaviors) as they do on treatment (providing services). Some governments have succeeded in inducing behavioral changes on a large scale: unprotected sun-bathing in Australia and drink-driving in the United Kingdom have been significantly reduced through measures to influence cultural norms.

3. THE ORGANIZATIONAL LANDSCAPE OF THE PUBLIC SECTOR MUST BE REDRAWN

To respond to the ten global trends, the public sector must transform its organizational landscape.

Boundaries within government. In many countries, the institutional framework of government was set more than 50 years ago. Typically, this involved the creation of monolithic ministries focused on delivering a basic standard of universal provision, whether in health, housing, or education. But this system cannot

A new institutional framework is needed



The postwar response to the “Five Giants” set out in the UK Government’s landmark 1942 Beveridge Report — Want, Disease, Ignorance, Idleness, and Squalor — was to establish separate, largely independent government departments to address each issue. Governments, in developed and emerging economies, increasingly recognize the need for a much more integrated approach.

deal with future challenges. Many of the most important issues facing governments around the world, such as poverty reduction and homeland security, require effective and coordinated responses across organizational boundaries. In welfare reform efforts in Australia, the United Kingdom, and the United States, for example, initiatives across taxation, benefits, education, employment, health care, and housing have been increasingly integrated across government departments and agencies.

Citizens require joined-up government too. For example, reducing the number of times that people need to inform the state of changes of address or a bereavement will require transforming operational processes, IT systems, and frontline staff skills. Some governments, as in California

and New York City, have established shared-services centers across multiple public-sector organizations, thereby improving the quality of service to their constituents while also achieving efficiency savings.

Collaboration across countries. Just as business has become more global, so have many of the issues that governments across the world need to deal with, be it climate change or organized crime, immigration or avian flu. The need for international collaboration between governments is not new, but it is extending beyond international relations to include collaborative policymaking and service delivery. Examples include the European Union's efforts on mitigating climate change or on sharing data on criminal records.

Boundaries between the public, private, and nonprofit sectors. As governments seek innovative ways to transform their productivity, we also expect to see the continued growth of the mixed economy between public, private, and nonprofit providers of public services; and the greater role of private and nonprofit organizations in taking on issues traditionally seen as the preserve of public policy.

This mixed economy approach has long been prevalent in Germany and the United States, where for example nonprofit hospitals comprise a third of the total. As it expands more widely, it will provide sources of innovation, shared risk, or access to the economies of scale of global providers. Outsourcing of public services (in public-facing and support services) will increase in areas where it is cost-effective and can be integrated into public-sector governance arrangements (which has not always been successfully achieved).

In the United Kingdom, for example, the logistics company DHL UK is poised to manage £4 billion (\$8 billion) of spending in the National Health Service, purchasing everything from beds to bandages.

Private-sector and nonprofit organizations are also playing an increasing role in addressing issues of public policy. International NGO programs such as the Bill & Melinda Gates Foundation's work on public health have, in part, been motivated by the perceived inadequacy of international governmental organizations. Private-sector organizations are also finding innovative ways to enhance sustainable economic development by creating commercial opportunities in areas of public policy such as water access, micro-finance, and the development of low-emission technologies. Manila Water, for example, has overcome the many obstacles to serving low-income consumers by harnessing local communities as a source of small-scale entrepreneurs, bill collection, and consumer education.⁸

This three-way engagement between public, private, and nonprofit, requires public-sector leaders to adopt a new mindset and capability to deliver through a wider network of policy and delivery partners.⁹

4. GOVERNMENTS SHOULD TRANSFORM THE WAY THEY EMPLOY DATA IN POLICYMAKING AND MANAGEMENT PRACTICE

Three management practices will become increasingly important in the public sector.

A greater focus on long-term planning. Public-sector organizations must always respond to short-term political priorities. In addition, governments face a range of important

⁸ See Christopher Beshouri, "A grassroots approach to emerging-market consumers," *The McKinsey Quarterly* 2006, Number 4

⁹ For more on this topic see *Governing by Network: The New Shape of the Public Sector*, Stephen Goldsmith and William Eggers, Washington, DC: Brookings Institution Press, 2004.

long-term issues, such as climate change, which require them to engage in systematic and long-term planning for periods far exceeding electoral cycles. Long-term planning must become an integral part of decision-making processes. In the private sector, major oil companies, including Shell, have established long-term strategy units that assess how the company should react to a range of 30-year scenarios, and the companies use the output of this process as a filter through which near-term decisions are assessed.

Many public-sector organizations have for years had long-term planning units, or have commissioned long-term reviews. However, in too many cases they contribute little to decision making. The UK government's Stern Review on the Economics of Climate Change may provide a model for placing this type of long-term thinking at the forefront of public policy, by creating a commonly accepted, systematically applied, evidence-based approach for short- and long-term decision making across government.

A step change in the use of data to inform decisions. Many governments lack a culture in which decisions

Greater use of data can be the foundation for productivity improvement

and performance are based on a clear understanding of the facts “on the ground” and the economic and operational drivers of performance. However, they are a prerequisite for reform.

In the 1990s, the New York City police department began using

CompStat, a data-driven performance-management system, to gain greater visibility of crime at street level, and its success led to its dissemination across much of the United States. International benchmarking of education across 60 countries by the OECD's PISA program has influenced reform in countries that include Germany, Japan and Mexico. In the United Kingdom, the Prime Minister's Delivery Unit has begun to instill a culture of data-driven public-sector reform across the civil service, and this approach is being replicated across the world. State asset-holding companies, such as Khazanah in Malaysia, Temasek in Singapore, and the Shareholder Executive in the United Kingdom, have applied data-driven management disciplines to state-owned enterprises, providing transparency, among other things, to the costs and benefits of political interventions.

Greater use of data can be the foundation for productivity improvement. During the German Federal Labor Agency's transformation, management carried out a segmentation of 20 million jobseekers by their mindsets and needs, and used this segmentation to prioritize spending on training and work-based programs. It also improved the speed and quality of service to jobseekers, introducing an Internet matching platform, for example, that brings together jobseekers and open positions throughout the country. These changes significantly contributed to €10 billion in cost savings, while also improving how the agency matched the needs of both jobseekers and employers.

A more systematic approach to information management. Collecting, managing, and deploying information is a core activity of many public-sector organizations in areas

as diverse as financial-services regulation, intelligence and security, crime prevention, and protecting vulnerable children.

For these and other organizations in the sector, information and risk management will become an increasingly core competency. Data-mining techniques, for example, are used more and more by governments to predict individuals' risk of unemployment or disease. Applying these techniques will require new capabilities as well as the ability to alleviate concerns about data privacy and equity.

5. THE PUBLIC SECTOR MUST IMPROVE ITS ABILITY TO COMPETE FOR TALENT

Around the world, executives in both the public and private sectors say their top challenge is locating high-quality, affordable talent.¹⁰ Indeed, talent management is moving from a sometimes overlooked support service to become a top priority.

Aging populations. Labor pools will shrink as populations age. Roughly 60 percent of US federal employees, for example, will become eligible to retire over the next ten years, leading to a huge drain of resources and expertise.¹¹ A very large proportion of teachers in many Western countries is nearing retirement, which raises a question of leadership succession, and is likely to cause a shortage of supervisors. In the United Kingdom, so many head teachers are close to retirement that a shortfall of experienced candidates is projected.

Shifts in economic activity. The transfer of economic activity to Asia, in areas such as computing and medical diagnostics, also means that some core skills needed by the public sector in regions such as North America

and Western Europe are likely to become scarcer too. This challenge is compounded by sensitivities relating to the offshoring of public-sector jobs and data security, which make it likely that the public sector will make less use of offshoring than private-sector companies.

Private-sector competition. The public sector will increasingly need managerial knowledge and expertise as much if not more than policy expertise, and will need to compete more directly with the private sector for talent. US government agencies, such as the Department of Labor, the Postal Service, and the Securities and Exchange Commission, have designed special programs to attract MBA graduates. The new joint masters program being developed by

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the Harvard Business School and the Kennedy School of Government at Harvard challenges notions of clear divisions between public- and private-sector skills. In many countries, the civil service has traditionally been able to attract very talented graduates. However, competing head-on with private-sector employers will require public-sector organizations to expand the pools of talent they recruit from, and to create more attractive propositions to recruit and retain people in terms of promotion trajectories, compensation, and leadership culture.

¹⁰ Global Survey of Business Executives, McKinsey research data, 2005

¹¹ "Issues in the Federal Workforce," Testimony to Congress by Linda Springer, OPM Director, March 6, 2007, www.opm.gov/News_Events/congress/testimony/110thCongress/3_06_2007.asp

A DYNAMIC DECADE AHEAD

Together, these ten trends and five implications will provoke a period of innovation and transformation that will make government an even more exciting environment in which to work and more responsive than ever to the needs of its citizens. Civil servants and politicians should therefore expect to operate in a context of radical, ongoing, and accelerating change, which will require strong and courageous leadership, as well as clear and persuasive communication of the case for reform. On the one hand, the scale of transformation required may seem daunting. On the other, it is a unique opportunity to attract and retain talented people, committed to the mission of government and ready to embrace a change that is ultimately at the heart of public service.

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