Government through business lenses

Introduction

Government is not a business. But applying 'business lenses' to the public sector can allow for distinctive perspectives and fresh thinking. Our analysis suggests that as the Government continues to recalibrate the public sector to a lower level of spending, it should consider reform through three such lenses: a productivity lens, a talent lens and a balance sheet lens. This chapter outlines the view through each.

The productivity lens

In 2010, Office for National Statistics (ONS) figures suggested that public sector productivity had been flat for 13 years. The amount of activity the public sector delivered, according to the ONS data, seemed inextricably bound to the amount of funding it received.

As austerity began, the ONS observed nascent improvement in the figures, with growth rates of 2.5 per cent in 2011 and 1.2 per cent in 2012.[44] The private sector tends to experience productivity gains during recessions, not least because workers in a declining workforce have to produce more, and the same could have been true of the UK public sector in austerity.[45]

Productivity gains can help the public sector maximise its efforts, focus on the impact it delivers and make the most of its funding. We suggest that every hour of public sector staff time saved in a year through better productivity is worth £57.7 million to the public sector in England, £2.9 million in Northern Ireland, £7.2 million in Scotland and £4.3 million in Wales – a total of £72 million to the UK's public purse.

As well as the importance of better productivity for the public sector itself, Cabinet Office Minister Matthew Hancock used a *Reform* platform to underline its importance in driving up the UK's overall productivity as well.[46]

The State of the State suggests that the UK's central governments can lead the pursuit of public sector productivity gains in five ways.

First, digital technology has a particularly significant role to play in more productive, cost-efficient working and its use should be accelerated. Bold projects, such as the move away from paper tax discs last year, illustrate the scale of potential. In their final year, 42.4 million paper discs were issued and their decommissioning is expected to save £10 million a year.[47]

For public sector organisations thinking through the potential of technology, Deloitte observes that successful digital transformation requires a fundamental change of mindset. Public sector leaders need to re-imagine their processes for a digital age, rather than recreate analogue activities in digital form. As well as rethinking what they will deliver, they need to rethink how they will deliver as traditional project management models may not work where technology and the organisation's needs are changing rapidly. Agile working and in-flight testing are often more appropriate for digital change.

Digital transformation often requires investment, and our interviews with public sector leaders in the following chapter suggest that this is a barrier to progress that the UK's central administrations could help overcome through 'invest to save' funding. Such investment should be led by the organisations themselves to support their own digital transformation, as the bodies with public accountability. The World Bank's chief information officer recently observed, "IT is not a cost to be constrained" but is a means of delivering solutions and more effective ways of working.[48]

Government could also act to make procurement processes better-suited to digital transformation. Reforms could allow for more digital-friendly procurement, reflecting programmes which often evolve during their delivery.

The second way that government needs to lead in productivity is to make it less abstract and more meaningful for the public sector. A framework and guidance for measuring productivity, best practice examples and shared definitions would demystify productivity and help accelerate change. The UK Government has committed to launching initiatives to boost productivity alongside this November's Spending Review, which should help put productivity in a real-life, public sector context.

The third way that the UK's governments can support productivity is by stimulating connections between interdependent and overlapping parts of the public sector. Over four years in the US, the Government Accountability Office identified 188 areas in which public bodies overlapped, duplicated each other's activities or missed opportunities to join up because they were too fragmented.[49] The UK's emerging local devolution deals have considerable potential to deliver productivity gains by making cross-sector connections. Beyond those areas, coordination across government departments and local public bodies has exceptional potential for system-wide gains.

Fourth, the Government needs to back the public sector in evidence-based reforms that may seem counter-intuitive and challenge widely-held beliefs. For example, there is a citizen view that police 'on the beat' help deter crime, but research suggests that officers have greater impact when deployed in more targeted ways.[50] Similarly, a 2012 study for the Department for Education suggested that extra funding in itself does not improve school performance.[51] And this year, a Deloitte report for the Ministry of Justice questioned the correlation between funding and performance, as currently defined, in youth offending teams.[52] These evidence-based insights each challenge popular thinking and question whether extra funding improves public services. They suggest a disconnection between citizen views and operational evidence that would require bold political leadership – local and national – to resolve.

The fifth way in which the UK's central governments can support better productivity is by supporting a move towards more customer-centred services. User-feedback is a critical part of that, especially in designing digital services, and social media could have a role to play. In the US, federal agencies are now encouraged to use Yelp – a review site similar to TripAdvisor – to gather actionable feedback on their services and engagement with the public.[53] Clearly, gathering feedback in a public forum would need to be managed appropriately, but it is worth noting that 43 per cent of Yelp reviews have given five out of five stars while just 14 per cent have given one star. In other words, citizens are not exclusively moved to offer complaints but also wish to comment on favourable experiences.[54]

A survey for Collaborate, a social business supporting cross-sector collaboration, found that less than a quarter of people – 24 per cent – feel that the public services always or often understand their needs and just 16 per cent feel that the public sector listens to their preferences. When asked to rank desirable characteristics for organisations delivering public services, respondents to the survey suggested that understanding people's needs is the most important.[55]

Seven characteristics of public sector productivity

Research for *The State of the State* assessed public sector reform programmes and high-performing organisations around the world to identify common themes and behaviours. That analysis points to seven characteristics of highly productive public sector organisations.

These seven characteristics may not be applicable to all organisations but are intended as simple reference points to help guide the pursuit of better productivity. They are:

1 *Talented people with a licence to deliver*
2 *No repetition, hesitation or deviation*
3 *Citizen-centric forces shape services and attract resources*
4 *Insight informs deployment and demand management*
5 *Technology helps people work smarter and cheaper*
6 *Form follows function*
7 *The journey never ends*

1. Talented people with a licence to deliver

Highly productive organisations attract talented people because they offer a salary that corresponds with the market rate for their skills and experience. Those rewards are enhanced by an engaging culture, flexible working choices and the opportunity to make a difference.

People in productive organisations enjoy a high performance culture, underpinned by authentic performance management. An active approach to talent management means that the organisation pre-empts the skills it needs to make sure that the right people are in the right posts when needed.

Talented people in highly productive organisations are given a licence to deliver because they are deployed according to their skills. Their organisation makes best use of their talent and maximises their working time by deploying them across multiple responsibilities.

2. No repetition, hesitation or deviation

Productive organisations have designed repetition out of their processes. Those that deal with the public make sure transactions are right first time to avoid unnecessary duplication of effort.

Hesitation is reduced in productive organisations because managers have enough autonomy to make decisions. While decision-makers recognise risks, they know they have the permission and authority to make a call.

Highly productive organisations are focused on the core of their mission – the public value that they create – and do not get sidetracked. So just like in the classic Radio 4 game, 'repetition, hesitation or deviation' are rarely found in the most productive public sector organisations.

3. Citizen-centric forces shape services and attract resources

The best public sector organisations put the citizen at the centre of their thinking. That means services are designed around the user experience and developed with their input.

Continued and transparent citizen interaction keeps the organisation connected to their needs. By understanding what the customer wants, productive organisations do not waste resources on initiatives that do not add value. They are active in seeking continuous, constructive feedback and they act on it.

The force of 'citizen-centricity' does not stop at agency boundaries. It pulls public sector teams and resources together from different organisations to work around service users in ways that generate cross-sector productivity gains.

4. Insight informs deployment and demand management

Highly productive organisations understand their environment and act on that insight. For public bodies, that means a working knowledge of where demand comes from for their services, the factors that affect it and how their resources are deployed to meet it. The principle applies as much to public service delivery organisations as it does to administrative teams with internal clients.

If an organisation understands how demands on its services operate, it can maximise its productivity in two ways. First, it can align its resources to demand. Frontline staff, for example, can be deployed when and where they are needed the most. Second, the organisation can shape citizen demand through preventative measures including behaviour change.

5. Technology helps people work smarter and cheaper

Public sector organisations can suffer from under-investment in IT. But technology is key to more productive working practices – whether the employee is in an office or in the field.

Highly productive organisations deploy technology that helps employees maximise their time. For office staff, that could mean better software, tools to help them collaborate with colleagues or new hardware that simply works faster. For field workers, mobile technology reduces their latent time and the need to return to an office.

Technology is also exploited to good effect in interactions with citizens. Many people in the UK have become accustomed to personalised, online self-service and are open to that kind of interaction with the public sector too.

6. Form follows function

Many UK public sector organisations have evolved over decades – even centuries – and sometimes in ways that have weighed down their productivity. Overlapping and duplication have often been introduced into the system. Opportunities for joined-up working have been missed as organisations grew in silos.

Highly productive organisations have been redesigned for today's needs. Where appropriate, back-office functions have been shared. Management has been delayered. In some cases, organisations have merged. While these activities have become commonplace across the UK public sector, considerable opportunities still exist.

New business models provide public sector leaders with varied options to recast their organisations. But whether internal change or more profound transformation is the most effective option, highly productive organisations tend to be structured around the principle that 'form follows function'.

7. The journey never ends

Debates around public sector reform can inadvertently perpetuate a myth: that change requires a brief period of activity to reach an end-point at which reform is permanently complete. But society, people and technology never stop changing. At the same time, every government will seek to shape the public sector in line with its agenda through a reform programme.

For these reasons, the pursuit of better productivity needs to be a continuous process rather than a one-off project. The most high-performing organisations never stop seeking efficiencies and new ways of working. In the private sector, competition drives that persistent search. For the public sector, a continual productivity journey is best achieved by fostering a culture of innovation and never-ending dialogue with service users.

Recommendations: through a productivity lens

The State of the State concludes that looking through a productivity lens, the UK Government and devolved administrations need to:

- accelerate the use of digital technology across the public services through 'invest to save' funding for public services as well as procurement reforms
- establish a meaningful framework through which organisations can agree definitions on productivity, pursue gains and share best practice
- generate productivity gains through departmental co-ordination, and through continued local devolution that integrates services and organisations
- back evidence-based reforms that may challenge widely-held beliefs on funding priorities, giving leaders across the public services license to make bold decisions that will improve productivity
- encourage the use of user reviews, social media and other research to access continuous user feedback on public services.

The talent lens

Advanced governments around the world are increasingly alive to the importance of talent, but unfortunately austerity has taken its toll on the UK's public sector workforce. As our interviews with public sector leaders in the next chapter show, redundancies, pay freezes and reduced promotion opportunities have affected morale. But as public sector organisations continue to reduce their headcount, redesign their operations and seek productivity gains, public sector leaders know that they need skilled and motivated employees more than ever.

Since 2010, the UK public sector headcount has gone down by 409,000, taking into account the effect of reclassifying employees in further education, the Royal Mail and banks acquired after the financial crisis.[56] That equates to a seven per cent drop in the total public sector workforce over the first half of this decade. Estimates suggest that the public sector headcount may fall by 800,000 from 2010 to 2020.

A survey for Totaljobs asked public sector staff how headcount reductions had been handled in their organisation. One-third of respondents felt that retaining highly skilled talent during the cuts was handled poorly, and a third thought that the opportunity to let underperformers go was badly utilised. The research concluded that talent had often left the organisation while employees with inconsistent performance had stayed.[57] That is also observed in the private sector during cost reduction. Public sector leaders need to view further losses in their organisations through a talent lens to make sure they do not lose capabilities that they will require in the medium term, after cuts have been made.

In Whitehall, as well as the Scottish and Welsh Government, the Civil Service People Survey provides a candid view of attitudes. The latest results show that civil servants have a clear view of their organisation's objectives and their contribution towards them. Encouragingly, they show that civil servants are interested in their work and enjoy a strong sense of accomplishment. Those attributes will be increasingly important to attract future talent: the Deloitte Millennial Survey shows that six in ten millennials choose to work for employers that provide them with a sense of purpose.[58]

Less encouraging is the view of pay and benefits that emerges from the survey. Against an engagement benchmark of 59 per cent, the Civil Service-wide score for satisfaction with pay and benefits is just 28 per cent. The lowest level of satisfaction in the entire survey comes when civil servants are asked to compare their pay to people doing similar jobs in other organisations. That benchmark score now stands at 24 per cent and has gone down every year since the survey began in 2009.[59]

These issues have serious implications for talent and capability in government. Europe-wide research by Deloitte found that lower public sector pay limits the pool of talent available for government finance positions and an NAO study of government procurement experts concluded that salaries for their roles are insufficient.[60] Those procurement professionals collectively administer £40 billion of contracts, so taxpayers might reasonably expect the Civil Service to employ people at market rates to manage their money, even if those rates are out of kilter with standard pay grades. Other examples of roles that require highly-marketable skills – not least for digital transformation – are common across government.

As a report for the cross-party think tank GovernUp concluded in 2014, the role of reward in public sector capability needs to be acknowledged, and pay levels for people with specific, high-value skills need to be reconsidered to recruit and retain talent.[61]

The Civil Service has seen considerable developments in its approach to talent in recent years. The Major Projects Leadership Academy (MPLA) has supported 350 civil servants in developing their skills and confidence since its launch in 2012. The MPLA, managed by Deloitte with the Oxford Saïd Business School, aims to address self-observed leadership capability gaps.

Encompassing other roles, the Civil Service launched a plan in 2013 to improve skills across four, self-diagnosed areas in need of development: leading and managing change; commercial skills and behaviours; delivering successful projects and programmes; and redesigning services and delivering them digitally. While those skills are all vital, our analysis of the future of government suggests that they need to be developed as part of a wider shift in expectations on Civil Service and public sector leaders of the future.

Deloitte research suggests that the best government leaders of the future will demonstrate a series of new abilities and behaviours that encompass multiple skill sets. They will be adept at connecting people, information and resources to deliver through complex networks. They will operate with a default level of transparency towards their colleagues and citizens, and use social media to engage both continually. Their decisions will be informed by evidence and they will test out their thinking by iterative processes as part of innovation.[62] These kinds of future behaviours and abilities – rather than individual skills – need to be nurtured by governments that want to shape their future talent.

Beyond leadership roles, if the public sector continues to shape around citizen expectations, some technical professions may need to become more customer-orientated or organisations will need to decide where customer care is centred within their workforce.

The impact of automation on employment has attracted considerable public attention this year, informed by a study for Deloitte by Oxford academics Carl Frey and Michael Osborne. Looking at the public sector roles within their data suggests that certain jobs have a high probability of being automated over the next ten to twenty years. The roles with the highest probability are set out in the table below.

Occupation	Probability of automation
Library assistants	**0.97**
Local government administrators	**0.96**
Inspectors of standards and regulations	**0.94**
Health care practice managers	**0.82**
School crossing patrol officers	**0.80**
Traffic and parking wardens	**0.80**
Street cleaners	**0.66**

Various technological advances are automating elements of these occupations. Digital and online technology is making a significant impact on how information is managed, how appointments are made and how data is processed. Sensors and digital imaging technologies are bringing that same impact into the physical environment, automating elements of traffic enforcement for example, through the Internet of Things. For some roles, technology is simply improving the speed and efficiency at which tasks are completed, and headcount can be reduced accordingly. For others such as school crossing patrols, recruitment difficulties could be contributing to the ongoing decline in numbers, in addition to technological advances.

In contrast, many roles found predominantly within the public sector are among the least at risk from automation in the next 20 years. Given the nature of their tasks, frontline roles including healthcare professionals, social workers, teaching staff, police and fire officers are all at low risk from automation, according to the research, because they require high levels of perception, creativity and social intelligence as well as varying degrees of physical manipulation.[63]

Recommendations: Through a talent lens

The State of the State concludes that looking through a talent lens, the public sector needs to:

- ensure that further headcount reductions are considered in relation to medium-term plans so that public sector organisations retain the talent and skills that they need
- recognise the role of reward in attracting and retaining talent, especially where specific and highly-marketable skills are needed
- develop leading-edge skills in future talent, recognising that the public sector needs new abilities and behaviours as well as specific skills.

Figure 8. The state's income statement

	2009-10 £billion	2010-11 £billion	2011-12 £billion	2012-13 £billion	2013-14 £billion	Notes
Revenue	583.4	614.0	616.6	620.7	648.5	The main source of revenue – what the state receives – is taxation. The state raised £559 billion in taxes in 2013-14. The major source of non-tax revenue is from the sale of goods and services including £24 billion earned by local authorities.
Direct expenditure	(619.5)	(663.3)	(647.8)	(665.8)	(663.8)	Government's direct expenditure covers all of its costs, including £213 billion of staff costs and £190 billion to purchase goods and services.
Other operating expenditure	(47.7)	(38.4)	(67.3)	(51.5)	(54.2)	Other operating expenditure includes £15 billion of impairment of assets and £39 billion of pension scheme costs and actuarial revaluations.
Net financing cost	(78.6)	(83.2)	(88.1)	(79.4)	(78.8)	Net financing cost includes £49 billion of interest on pension scheme liabilities and £32 billion interest for government borrowing.
Other	(0.3)	(0.3)	1.3	(2.7)	(0.3)	Revaluation of financial assets and liabilities as well as net loss on disposal of assets.
Net expenditure for the year	(162.7)	(94.4)	(185.3)	(178.7)	(148.6)	Net expenditure describes the shortfall between the government's income and its expenditure in accounting terms.

Figure 9. The state's balance sheet

	2009-10 £billion	2010-11 £billion	2011-12 £billion	2012-13 £billion	2013-14 £billion	Notes
Assets	1,249.5	1,234.3	1,270.6	1,297.5	1,337.3	Assets – what the state owns – include £358 billion of land and property.
Liabilities	(2,477.4)	(2,420.0)	(2,617.5)	(2,925.4)	(3,189.1)	Liabilities – what the state owes – include £1,302 billion of public sector pension liability, £1,096 billion of government borrowing and £142 billion of provisions for events that are likely to happen in future.
Net liability	(1,227.9)	(1,185.7)	(1,346.9)	(1,627.9)	(1,851.8)	Net liability – the difference between assets and liabilities – has risen by £624 billion since the first set of accounts.

The balance sheet lens

Reading the UK state's income statement and balance sheet* allows for analysis of its underlying financial health and sustainability. This accountancy view has been made possible by HM Treasury's production of Whole of Government Accounts (WGA). Produced annually since 2009-10, WGA are the largest consolidated public sector accounts in the world and represent a major achievement in public financial management. Along with HM Treasury and Deloitte's 'Simplifying and Streamlining' project to improve the usability of public sector financial reporting, WGA continues to establish the UK as an international leader in public financial reporting and accountability.

A shortform of the most recent WGA report, for the 2013-14 financial year, is shown in figures 8 and 9.

Now that five sets of WGA have been published, clearer trends are beginning to emerge: the effect of the Government's austerity measures on its income statement is becoming apparent in the latest accounts as net expenditure has decreased by £14 billion since 2009-10. Since the previous fiscal year, the income statement shows a reduction of direct expenditure of £2 billion, which includes a reduction of £1.2 billion in public sector wages.

Offset against this expenditure, the Government has seen an increase in revenue of 4.5 per cent overall, with a 6 per cent increase in tax income.

Two significant issues arise from reading the past five years of WGA balance sheet. First, the Government's net liabilities have increased by £624 billion or 51 per cent since 2009-10. That includes £314 billion of borrowing to fund the deficit and £167 billion of rising public sector pension liability.

The substantial liability increases are clear cause for concern and the Government is addressing them by reducing expenditure with an aim to eliminate the deficit, reduce debt and reform public sector pensions. However, the impact of those reforms will not be evident in WGA for some years.

*The term 'income statement' and 'Balance sheet' is used in the interests of broad understanding though for the public sector 'Statement of Comprehensive Net Expenditure' and 'Statement of Financial Position' are technically more accurate under the public sector financial reporting and International Financial Reporting Standards.

An increase in Government liabilities may be driven by the classification of new entities as public sector by the ONS, resulting in the consolidation of these bodies into the WGA. In structuring arrangements, for example, outsourcing or PFI arrangements, the Government should give early consideration to whether the ONS will classify any new entity or arrangement as part of the public sector, thereby bringing the assets and liabilities of these entities within the Government balance sheet.

Second, provisions for costs that the state expects to incur have increased by £40 billion since 2009-10. That increase is mainly due to a 37 per cent rise in provisions for nuclear decommissioning and a 69 per cent rise in provisions for NHS negligence. The UK Government is acting to stem these rises, which could otherwise put pressure on the public finances in years to come. The Government has moved to a new model which shifts decommissioning responsibilities for future power stations onto private sector partners. That should share risks between the public and private sectors and provide for greater value for money over time. However, ultimately the decommissioning provision is likely to continue to be held by the public sector as the only body able to undertake the activity. Similarly, to reduce the pace at which the NHS negligence provision continues to grow, the Government legislated to stop lawyers charging 100 per cent success fees on their costs. However, this was counter-productive in the short term as it is thought to have driven 1,000 new claims per month for six months before it came into force, representing an 18 per cent rise.

The debt reduction dilemma

Viewed through a financial statement lens, the Government faces a debt reduction dilemma. Paying down its £1.5 trillion debts as quickly as possible would reduce exposure to risk and debt servicing costs, but could require a continuation or acceleration of austerity measures. Conversely, with interest rates low there is an argument to let high debt levels continue and pay debts down over decades, allowing for greater public spending and investment. Of course, the reality is complex, and it is far from a binary choice; for example continuing or increasing borrowing while interest rates are currently low is likely to have a longer run effect on underlying interest rates, thereby increasing repayment costs overall.

Analysis by the OECD suggests that governments should consider their 'fiscal space' when making this judgement, which is essentially their room for manoeuvre on debt levels before they cause an immediate concern to markets. The analysis suggests that 22 advanced economies have enough 'fiscal space' to consider such a long-term solution, along with high employment and normal interest rate levels.[64] The UK is in that group – but only just. In the OECD's ranked order of 22 states, the UK is second from the bottom.

The Chancellor's Summer Budget implies that the Government favours a longer-term, organic approach and is planning to reduce its debt over decades by running an ongoing budget surplus. While that provides more scope for investment, the Treasury's modelling suggests that debt might not return to its pre-financial crisis level until beyond 2035, assuming optimistic economic conditions.

Of course, a long-term fiscal strategy requires future administrations to comply. For that reason, the Government is introducing a Charter for Budget Responsibility as a governance mechanism. The Charter commits the UK to staying in surplus – therefore spending within the limits of how much it is prepared to tax its citizens – in order to maintain financial discipline and reduce debt over time. While future governments would be able to amend the Charter or can set their own fiscal targets, they will be subject to parliamentary scrutiny and assessment from the independent OBR.

As the IMF pointed out this year, legislative devices like the Charter can anchor government policy and act as a guide towards medium-term objectives. Such mechanisms are particularly vital, in the IMF's view, for governments with high debt levels and an ageing population that will put pressure on public spending in the decades ahead – just like the UK.[65]

While the Charter is a significant development with far-reaching implications, the Government still needs to pay close attention to its balance sheet in policymaking. Student loans illustrate why this is so important: they are expected to add more than nine per cent of GDP to public sector debt within the next fifteen years. However, of the £64 billion that has been lent to students, just £42 billion is expected to be recovered. Assessing the real cost/benefit to the financial position of the country is complex, as increased access to higher education also drives increased higher-skilled job creation and gross domestic product, giving rise to additional tax revenues over the longer term. Student loans are, therefore, one major example of the complexities of policy-making's impact on the state's financial position.

Recommendations: through a balance sheet lens

The State of the State concludes that looking through a financial statements lens, the government needs to:

- evaluate new ventures to assess whether they are likely to be classified as part of the public sector and would therefore add to the public sector balance sheet
- ensure that policy decisions are assessed for implications on liabilities, and act to drive down the state's net liabilities over time to manage the UK's exposure to risk and unsustainable trends
- continue development of Whole of Government Accounts in line with National Audit office (NAO) guidance so that they become a single view of the state's financial position, used across government to inform policymaking.