Part I

Finding Your Leverage

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Chapter 1

The Five C's: Changing Government's DNA

Margaret Thatcher: Discovering the Power of Strategy

By 1986, Margaret Thatcher was frustrated with her inability to move the British bureaucracy. For seven years, she had administered dose after dose of tough medicine: downsizing, privatization, efficiency audits, war with the unions. But she had failed to change the behavior of her civil service.

Thatcher and her Conservative Party had come to power in the winter of 1979, pledging to revive Great Britain's slumping economy by reducing the size of government, cutting spending, and slashing taxes. Gross domestic product (GDP) was in free fall. Inflation, at 10 percent, was accelerating. Public revenues were stagnating, public spending was rising, and public services were eroding. Government consumed 44 percent of GDP. It owned huge portions of the economy: coal mines, the oil industry, the gas and electrical industries, auto companies, an airline, an aerospace firm, and dozens of other nationalized industries. (By comparison, government in the United States consumed about 35 percent of GDP at the time.)

Thatcher's instinct had been to slash away. At her first cabinet meeting, she announced a hiring freeze and a 3 percent cut in the civil service; several months later she imposed an additional 5 percent cut. On her fourth day in office, she asked Sir Derek Rayner, who ran the well-known retail firm Marks & Spencer, to lead a crusade against waste and inefficiency. Rayner recruited six aides and launched a classic exercise favored by politicians determined to root out waste: efficiency audits of targeted programs and processes. Designed to streamline operations and eliminate waste, they became known as "efficiency scrutinies."

Under the watchful eye of Rayner's Efficiency Unit, government departments conducted 223 scrutinies in the first three years. They led to the elimination of 12,000 positions and recurrent annual savings of £180 million. (A pound was worth $1.50 to $2.32, depending on the year.) They were effective in making specific changes, but, as leaders of the Efficiency Unit readily admitted when we talked with them, they did not lead organizations to pursue continuous improvement. They helped weed the garden, patch by patch, but they did not develop a regimen that kept the garden weed-free.

Thatcher also took on the public sector unions, pushing through reforms that outlawed secondary pickets, restricted union shops, and encouraged secret ballots in union elections. In 1981 she stared down the civil service unions when they struck for five months. And in 1984 and 1985, she defeated the powerful mine workers union, which struck to keep the government from closing coal pits that were losing money.

But Thatcher's big weapon was privatization. In her 11 years, the government sold more than 40 major state-owned enterprises— including British Petroleum, Britoil, Jaguar, British Telecommunications, British Steel, British Airways, and Rolls-Royce—plus many smaller enterprises and more than 1.25 million public housing units. By 1987 these sales were pulling in £5 billion a year, helping Thatcher balance her last four budgets. (By 1994, the cumulative total was $75 billion.) "By the time I left office," she later boasted, "the state-owned sector of industry had been reduced by some 60 percent....Over six hundred thousand jobs had passed from the public to the private sector."

Thatcher also clamped a spending lid on local government, most of whose revenues came from the national level. In 1980 she required "compulsory competitive tendering"—competitive bidding between public and private providers—for all local building and highway construction. Two years later she established an independent Audit Commission to oversee auditing of local governments and pressure them to increase their efficiency. And in 1984 she imposed limits on local tax rates.

These reforms not only forced local governments to change the way they did business, they helped shrink the size of government. During Thatcher's reign public employment fell from 30 to 24 percent of the workforce, dropping to its 1961 level, and government spending fell from 44 to 40.5 percent of GDP. Privatization not only reduced the size of government, it freed companies like British Airways to transform themselves into world leaders. But in the core civil service—the non-enterprise, non-health-care departments where 600,000 civil servants still labored—performance changed very little.

In short, jamming the bureaucracy was not getting the prime minister where she wanted to go. When she privatized an enterprise or cut a budget or launched an efficiency scrutiny, nothing changed in other departments. No other dominoes fell. She needed a strategy beyond privatization and efficiency scrutinies.

The Next Steps: Uncoupling Steering and Rowing

When Thatcher and her colleagues entered office, they held most public employees in contempt. They threw around slogans like "Deprivilege the Civil Service." But as Thatcher worked with administrators who impressed her, her attitude changed. "She found herself confronted with civil servants who were entrepreneurial," says Michael Clarke, head of the University of Birmingham's School of Public Policy. "She encouraged and promoted a range of those people—she had an eye for 'can do' civil servants." In fact, Thatcher triggered a revolt in her own party in 1985 by raising salaries for top civil servants by as much as 50 percent.

Thatcher also began to learn more about the systemic problems behind government's waste and inefficiency. In 1982, the Efficiency Unit and one of her ministers, Michael Heseltine, convinced her to launch a new management initiative. Upon taking office, Heseltine had discovered that his department had no adequate financial management system, so he had set about creating one. He and his civil servants had built a system that set objectives for each unit, defined their budgets, and measured both their spending and progress toward objectives.

Thatcher, Rayner, and the Treasury Department took the idea government-wide. Their Financial Management Initiative required departments to set performance objectives for all managers: what they expected to achieve, by when, and at what cost. It broke departmental budgets down and made each unit responsible for managing its own funds. It required new management information systems that could give managers reliable data on the costs of their activities. All this was held together by a "top management system," through which departments prepared annual statements summarizing the performance and plans of their units. Ministers, top management, and unit managers would review these and agree on action plans.

Thatcher invested considerable sums in the computer systems necessary to run the Financial Management Initiative. The government built up more than 1,800 performance objectives, most of them focused on cost and efficiency. But the impact of the new system was disappointing; it had little effect on the behavior of the civil service. It created valuable information, but it did not change the fundamental dynamics of government organizations. In

1986 Thatcher asked Rayner's successor, Sir Robin Ibbs, to assess the initiative and recommend the next steps.

By now the Efficiency Unit had six years of experience under its belt. Its members—drawn from both business and government—had learned a great deal about the realities of management in the public sector. They had long since lost interest in knee-jerk solutions.

In the previous 150 years, prime ministers had commissioned many blue-ribbon inquiries into the problems of public management. But not one had asked the bureaucrats what they thought. The Efficiency Unit did just that. Over three months, its members interviewed hundreds of civil servants, as well as businesspeople and experts on public management.

They found—indeed, they no doubt already knew—that the time-honored British system of public administration made good management almost impossible. Senior civil servants were not trained for management and did not care about management. The elite members of the civil service advised ministers on the great policy issues of the day. They did not stoop to get their hands dirty with implementation, and they looked down on managers—who did—as second-class civil servants. They took their marching orders from elected ministers, who were consumed by politics and policy. Like cabinet secretaries in any large nation, few ministers even saw management as their job. As Rayner once put it, "leadership has too often in the past fallen into the hands of those who know nothing of management and despise those who do."

Managers were so far down the civil service pecking order that they had little real control over what they were supposed to manage. Power was centralized at the top of the departments and in the Treasury Department, which combined the powers of a central office of management and budget, a central personnel office, and an American-style Treasury Department.

The results of the system were predictable. The Efficiency Unit report described a shortage of good managers; little top-level focus on the delivery of public services; a budget and finance system focused more on controlling spending than on making it effective; and few external pressures on government managers and organizations to improve performance.

In addition, the Efficiency Unit pointed out, the civil service was "too big and diverse to manage as a single entity." "Recruitment, dismissal, choice of staff, promotion, pay, hours of work, accommodation, grading, organization of work, the use of IT [information technology] equipment are all outside the control of most civil service managers at all levels," it said. The civil service rule book was "structured to fit everything in general and nothing in particular." Managers viewed the personnel system as a huge constraint on good management—but a constraint that was impossible to change.

In sum, the Efficiency Unit concluded, the civil servants were not the problem; the systems were. Ibbs had not intended to recommend radical reform, but it was clear that the systems and structure of the bureaucracy would have to change if effective management were to become a priority.

The unit's 1988 report, "Improving Management in Government: The Next Steps," argued that to solve the management problem, the government would have to separate service-delivery and compliance functions from the policy-focused departments that housed them—to separate steering from rowing. Second, it would have to give service-delivery and compliance agencies much more flexibility and autonomy. And third, it would have to hold those agencies accountable for results, through performance contracts.

The Efficiency Unit proposed, in other words, an arm's-length performance contract between departments and their agencies, in which departments traded the freedom agencies needed to manage effectively for the performance standards ministers needed to hold them accountable. Ibbs and his staff envisioned a civil service with a small core at the center supporting ministers, doing policy work, and managing departments, while the bulk of civil servants worked in relatively independent agencies.

Now in her ninth year as prime minister, Margaret Thatcher stepped up to the challenge. She accepted all of the unit's recommendations— including its urging that an "extremely" senior official be appointed project manager and given "unequivocal personal responsibility for achieving the change." She appointed Peter Kemp, a senior Treasury official who had come into the civil service from the private sector and was known as a maverick, to oversee the Next Steps program. Kemp staffed his team with bright, young, high-level civil servants on loan from their departments. They fleshed out the Next Steps proposals, developing a process that would:

- separate departments' service-delivery and compliance functions into discrete chunks, each one called an "executive agency";
- give those agencies much more control over their budgets, personnel systems, and other management practices;
- use a competitive public-private sector search—a radical break with civil service practice—to find chief executives for executive agencies;
- require chief executives to develop three-to-five-year corporate plans and one-year business plans;

- negotiate a three-year "framework document" between each agency and its departmental minister, specifying the results it would achieve and the flexibilities with which it would operate;

- pay chief executives whatever it took to get the talent needed, including performance bonuses of up to 20 percent of their salaries;

- deny chief executives the civil service's normal lifetime tenure; and

- require them to reapply for their jobs every three years.

Kemp quickly signaled the importance of Next Steps and captured the imaginations of reformers by announcing that his target was to move 75 percent of the civil service into executive agencies. The Treasury asked all departments to review their functions and decide upon one of five options for each: abolition, sale, contracting out, conversion to executive-agency status, or preservation with no change. Once a functional area within a department had been nominated for agency status, it was referred to a project executive team, whose members included representatives from the department, Kemp's staff, and the Treasury. They negotiated framework documents outlining the flexibilities granted the agency and the outputs expected. The Treasury acted as a gatekeeper, refusing to approve agency status until it was satisfied that true performance accountability was in place.

Kemp and his Next Steps team hit the ground running. Deliberately starting with organizations that were ready for agency status, they created eight agencies in the first year, 1988-1989. By early 1991 they had established 51 agencies, a pace that surprised most observers. By mid-1992 half the civil service worked in executive agencies, and by late 1996 the process was all but complete: nearly 75 percent of the civil service worked in 126 agencies. (The 75 percent figure includes 50 executive offices within two large departments, Inland Revenue and Customs and Excise, that operate along Next Steps lines but are not technically described as executive agencies.)

Finding the Leverage Points

There are many lessons to be learned from the British experience. It shows, for example, that reinvention requires collaboration between elected officials and civil servants—between what we call the political and institutional sectors. There were many things the civil servants would never have done on their own, and there were an equal number of things the politicians would never have seen on their own. Both sides had their blind spots.

More important for this book, however, is the lesson the British learned about strategy. Margaret Thatcher could not succeed on instinct alone. Her first attempts to reform the civil service bureaucracy—staff cuts and efficiency scrutinies—were inadequate. They did not create a domino effect, forcing everything else to change. In a word, they were not *strategic.* It was not until her Efficiency Unit developed strategies capable of creating that domino effect that she began to make headway.

By strategy, we do not mean detailed plans. There is no recipe you can follow to reinvent government, no step-by-step progression you must adhere to. Many writers and consultants discuss organizational change in terms of "stages" that they put into a neat, linear order. But the process is not linear, and it is certainly not orderly. Things rarely go as planned; reinventors must constantly adjust their approaches in response to the resistance and opportunities they encounter.

By strategy, we mean the use of key leverage points to make fundamental changes that ripple throughout government, changing everything else. Reinvention is large-scale combat. It requires intense, prolonged struggle in the political arena, in the institutions of government, and in the community and society. Given the enormity of the task and the resistance that must be overcome, the reinventors' challenge— whether in the U.K., the U.S., or elsewhere—is to leverage small resources into big changes. Being strategic means using the levers available to you to change the underlying dynamics in a system, in a way that changes everyone's behavior.

The word "strategy" originated in a military context: the Greek *strategos* means "general." Good generals begin by developing strategies: not operational plans, but basic approaches capable of altering the balance of forces in the field. When the U.S. chose to force Iraq out of Kuwait in 1991, its generals decided their leverage was twofold: massive bombardment to blind and debilitate the enemy, then quick, stealthy movement of divisions to create a pincer-like ground attack. These two strategies set the stage for day-to-day operational tactics, which guided the use of tools such as jets and tanks.

Margaret Thatcher and her advisors did something similar. They located their government's key leverage points and used them to change the balance of forces—to alter the basic dynamics within the public sector. The Next Steps process changed three leverage points: it uncoupled rowing organizations from steering organizations, so each could focus on its primary mission; it gave rowing organizations control over most of their own decisions, so they could make the changes necessary to improve their operations; and it created consequences for their performance, so they would have incentives to improve.

These new dynamics unleashed tremendous changes within many agencies. The basic tasks of writing the framework document, corporate plan, and business plan quickly forced into the open many of the problems that had to be dealt with. They forced agencies to define their missions, objectives, and performance targets. "Before Next Steps," explains Treasury official Mark Perfect, "the Department of Transport could say convincingly that it was far too complicated to define outputs for all of what it did. The agencies can't say that."

Agencies improved at varying speeds—some rapidly, some slowly. But overall, they managed to hit 75 percent of their performance targets in the early years. They have gradually raised many of these targets, but by 1995 they were hitting 83 percent. To improve their performance, agencies have used almost every tool in the reinventor's kit: contracting out, public versus private competition, accrual accounting, performance bonuses, group bonuses, total quality management, customer surveys, business process reengineering, internal markets, marketing to new customers, credit card payments, "one-stop" offices, and on and on.

The Vehicle Inspectorate, the first agency created under Next Steps, quickly opened offices on Saturdays and Sundays, for example. It introduced a series of new services, contracted out some old ones, removed a layer of management, and established group performance bonuses keyed to overall efficiency increases. In its first three years it reported operating cost efficiency increases of 4.5, 4.1, and 3.6 percent—triggering bonuses of up to £213 per employee. (Operating costs in the U.K. are known as "running costs"; they include all payroll, overhead, rent, and other operating expenses, but not direct program costs such as benefits paid to customers.)

The Information Technology Services Agency in the Department of Social Security set up customer account managers for all its customers, developed service agreements spelling out what it would deliver at what price, launched annual customer surveys, and contracted with private firms to supply virtually all of its information technology services. In its first five years it reported running cost efficiency increases of 5.5, 4.5, 16.2, 30, and 17.4 percent.

The Employment Service, one of the largest executive agencies, began measuring performance and publishing comparative data about each of its nine regions, to force improvement. Later it pushed the comparisons down to the local office level; each now displays its performance record and the records of up to six neighboring offices. At the same time, Chief Executive Michael Fogden gave his regions great flexibility. Many have cut waiting times dramatically. Most have changed the look and layout of their offices, putting in carpeting, bringing in plants, having employees wear name tags, and getting rid of glass barriers. The entire agency has eliminated a layer of management and restructured its personnel system, including pay, grading, and recruitment. Fogden has instituted regular customer surveys, customer panels, and customer service standards. The surveys show general improvement, while other indicators show a 40 percent increase in job placements with no new resources, gradual improvements in the accuracy of benefit payments, and 2 percent annual increases in running cost efficiency.

Some departments were reluctant to give the agencies the freedom they needed to maximize performance, according to a 1994 review of the agency process. This created a tug-of-war between departments and agencies. But the agencies' record of achievement gradually convinced the Treasury Department to give them enormous flexibility on budget and personnel matters, which resolved their most pressing problems. Once convinced that agencies would not overspend their budgets, Treasury gave them (and all government departments) control over their own budgets, pay structures, bargaining, and personnel grading systems for all but the most senior civil servants. It consolidated a stack of thick volumes into one book of essential personnel rules.

Treasury also allowed agencies to carry over any unspent funds into the next year. The trade-off was a four-year spending freeze on running costs, requiring agencies to generate any pay increases or inflation adjustments out of their own savings—their "efficiency dividend." In 1994-1995, the 80-plus agencies in existence decreased their running costs by an average of 4.7 percent. The fiscal squeeze contributed to a 15 percent reduction in the size of the civil service between 1988 and 1996.

Overall, Next Steps is widely viewed as a resounding success. In November 1994, Parliament's Treasury and Civil Service Committee called it "the single most successful Civil Service reform programme of recent decades." The unions have not opposed it, and as early as 1991 the Labor Party announced it would keep Next Steps in place if it won power.

Market Testing: Increasing the Consequences for Performance

While pleased with the initial improvements the Next Steps agencies offered, Thatcher and her advisors wanted more. They had watched privatization produce sudden, quantum leaps in productivity. Their initial experiments with competitive contracting, at both the national and local levels, had also yielded large savings. They wanted to inject the sense of urgency created by privatization and competition into the agencies—an urgency far greater than they could achieve with performance contracts and bonuses. They decided they needed a new strategy.

The result was a white paper called "Competing for Quality." Actually published in 1991, after John Major succeeded Thatcher as prime minister, it announced a series of decisions to inject more competition into public service delivery. First, it required that agencies be reviewed every time their framework documents expired. Every three years (now every five years), departments put agencies on trial for their lives. Using what they call a "prior options review," they examine each agency's function and performance to see if the entire agency or pieces of it should be abolished or sold. If they decide to keep an agency alive, the department tells it how much of its work it must competitively bid—a process called "market testing." The agency can ask for private sector bids only, or it can let its units bid against private companies for the work.

The white paper actually covered all government activities, not just executive agencies. It ordered local governments to competitively bid (public versus private) many white-collar services. (In 1988 Thatcher had required them to competitively bid more blue-collar services.) It required departments to bring in private sector help in analyzing the most promising areas for privatization and contracting, and it gave them an incentive to privatize by allowing them to keep any savings achieved. It offered no job guarantees to civil servants, effectively ending their job-for-life tenure. It did, however, promise that if agencies lost work, "every effort will be made to deploy staff elsewhere within the department. The contractor will be encouraged to re-employ staff."

Within the first five years, prior options reviews resulted in decisions to privatize more than a dozen executive agencies. In September 1995, the government reported that it had also conducted hundreds of market tests, covering £2.6 billion of services (about $4.3 billion) and resulting in annual savings of more than £500 million (about $815 million).

The pressure of competition has driven rapid change inside public organizations. Where public and private providers have competed head-to-head, public providers have won twice as many contracts (although the private sector has won larger contracts, on average). Regardless of who wins, savings are averaging 21 percent.

The Citizen's Charter: Making the Customer Powerful

Even their advocates admit that while Next Steps and market testing created internal management improvements and heightened efficiency, they did much less to improve effectiveness—the *quality* of public services. These strategies pushed agencies to improve their performance in the *eyes of the government,* and the Conservative government was obsessed with efficiency.

But the public cared about far more than efficiency. Citizens wanted public services to be effective: they wanted the subways and commuter trains to run on time, the mail to arrive in one day, and their children to receive a quality education.

To force agencies to look beyond efficiency—to produce quality services for their customers—the government needed a new strategy. It needed to make agencies directly accountable to their customers. The answer was John Major's favorite reform, the Citizen's Charter.

Major was the rare Conservative leader who had grown up working-class, experiencing firsthand the shoddy quality of public services. As one aide put it, he knew too well the attitude of many local councils toward citizens: "We know what you want, and this is what you're going to get, and you're going to like it."

Major launched his new strategy in July 1991. It was a typical political initiative, rushed out by a politician intent on making a point with the electorate before the next election, which was a year away. Diana Goldsworthy, a Next Steps team member who became deputy director of the Citizen's Charter unit, tells the story:

> *The Charter was launched precisely at the point when managers needed to do something about the question of quality. As we set these agencies up, they started talking about "customers" and "customer service." To start with we used the words very loosely. Then people began to say, "Well, what is in it for the customer? What gets better? What are we actually saying about quality of service?"*
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> *When we looked at that question, we found we had no language to describe quality, no currency. What's more, we didn't have a sponsor for quality. Who was it that was saying, " You can't launch this agency unless the service gets better?" There was nobody saying that. In fact, I've still got some overheads from a seminar that we invited a consultant to do with us, to tackle this question of quality. Quite literally, as we were finishing the seminar, we got this note from them saying, "The prime minister has decided he wishes to launch a public service initiative called Citizen's Charter." We all said, "What does this mean?" And they said, "You work it out." Almost literally, we said, "Right, let's go. Now we've got political will as well as managerial need."*

The basic approach they developed was elegant. All public organizations—national and local—would establish customer service standards, created with input from customers, and promise to meet them. (For example, "90 percent of trains should arrive within 10 minutes of the scheduled time," or "When you telephone a Jobcentre your call should be answered within 30 seconds.") They would be encouraged to offer redress if they failed to meet their standards—British Rail would offer discounts on commuter passes, for instance. They would set up systems to deal with customer complaints. And the government would require audits and inspections and publish comparative performance tables on local services, schools, and health services. If a public organization succeeded in meeting nine charter criteria—including customer choice, service quality standards, independent validation of performance, and continuous improvement in both quality and customer satisfaction—it could apply to use the "Charter Mark," a new symbol of public sector quality. But every three years it had to reapply, and to win again it had to demonstrate continued improvement.

Despite its conceptual elegance, Major's initiative got off to a horrible start. He announced it with great fanfare, but the white paper had no actual charters in it—only examples of what charters might say. When agencies and departments began to publish charters, most were long on general promises—"We will deliver prompt and courteous service"—but short on specific commitments, and shorter still on redress. They had no *teeth*.

With a name like "the Citizen's Charter," people also expected a Magna Carta, a document giving certain rights to the public. When the media discovered it was more about waiting times and how quickly public servants would answer the phone, there was a great feeling of disappointment. As one reformer put it, "You promised us a revolution, and we got a hotline?"

Because the Charter was so closely identified with the prime minister, the press and politicians paid close attention—and did not hesitate to express their cynicism. The Labor Party took every opportunity to ridicule the idea.

It took several years to overcome the initial black eye. But by 1995, the media were beginning to treat the charter idea with grudging respect. It had led, after all, to comparative performance tables on public schools, hospitals, and local services, which were so popular they consumed pages in the newspapers every time they were published. There were 40 national charters—some of which had been rewritten at least once to strengthen them—and hundreds of charters published by local authorities, hospitals, general practice medical groups, police departments, and schools.

Some organizations had used their service standards to drive very visible improvements in service.

- The National Health Service had lowered waiting times that had once been as long as two hours to a maximum of 30 minutes. It had also cut waiting times for elective surgery. In March 1990, for instance, more than 200,000 patients had been waiting more than a year for hospital admission; by March 1995 the number was down to 32,000.

- British Rail had improved service on many lines. On one heavily used commuter line in the London area, known as the "Misery Line," it raised the percentage of trains arriving within ten minutes of their scheduled time from 78 percent in 1991 to 88 percent by the end of 1994. In 1993-1994, British Rail had to pay £4.7 million in compensation to passengers and £2.4 million in discounts to season ticket holders (excluding strike compensation); in 1994-1995 BR got the numbers down to £3.5 million and £0.2 million.
- The Passport Office had lowered the time it took to get a passport from up to 95 days to a maximum of 15 working days.

By early 1996, the London Underground (the subway system) had met its standards and revised them upward three times. More than 400 public organizations had won the right to display the Charter Mark. But the Charter was still only beginning to tap its potential. Like the competition spurred by market testing, the Citizen's Charter will never stop pushing public organizations to improve. "This is the thing that I think is so interesting about the Charter," says Diana Goldsworthy:

> *Imagine getting a politician to sign up to do something which invites the public to raise their expectations and never be satisfied. Because you're never going to be able to turn around and say, "We've done it." The public will always want better service.*

Excerpts from the Patient's Charter

- "When you go to an outpatient clinic you can expect to be given a specific appointment time and be seen within 30 minutes of that time."
- "If you call an emergency ambulance, you can expect it to arrive within 14 minutes in an urban area, or 19 minutes in a rural area."
- "If you go to an accident and emergency department you can expect to be seen immediately and have your need for treatment assessed." If you are admitted, you will be given a bed within two hours.

Excerpts from the Passenger's Charter

- "If you are delayed for more than an hour on any leg of your rail journey, we will normally offer vouchers to the value of 20 percent or more of the price paid for that journey."
- "If, over the last year, your train service didn't meet its punctuality or reliability targets, British Rail will offer you a discount when you renew your season ticket." [Typical punctuality and reliability targets: that 90 percent of trains should arrive within 10 minutes of the scheduled time and that 99 percent of scheduled trains should run.]
- "If on average over the previous 12 months either punctuality has been more than three percentage points below target or reliability has been more than one percentage point below target we will give a discount of 5 percent."
- "If both punctuality and reliability were below those thresholds, we will give a discount of 10 percent."
- "Our standard for ticket office service is that you should not have to wait more than five minutes at any time. Outside the busy periods we aim to serve you within three minutes."
- As the railways are privatized, the new railway companies will have to produce their own charters. Compensation payments will be at least as good as those in British Rail's current charter.

What a Difference a Strategy Makes

Margaret Thatcher did not start out with a full-blown strategy to reinvent government. She came into office determined to make it smaller, privatize many functions, and force the bureaucrats to be more efficient. But unlike her counterpart in the U.S., Ronald Reagan, she learned from the failure of her "jam the bureaucrats" approach. She also had more time in office, and in her third term, she began to apply a consistent philosophy of extending choice and competition to public services and decentralizing authority so providers had the flexibility to respond to their customers' needs.

Thatcher had a team of advisors she trusted, who came to understand the real problems that lay behind public sector performance. In her ninth year in office they articulated a set of systemic changes that applied her philosophy to core government functions. It took them a long time to get there, and they made many mistakes along the way. There are still internal consistencies in some of their strategies. They embraced decentralization, for instance, while using top-down orders to dictate how local governments work—a practice that sowed cynicism at the local level and created the potential for political backlash. Still, they managed to find and use a series of key levers:

- privatization of functions better performed by businesses operating in competitive markets;
- uncoupling steering and rowing;
- performance contracts;
- decentralization of authority to units responsible for work;
- public-private competition; and
- accountability to customers through choice, customer service standards, and customer redress.

In our research, we have found these same levers used again and again: in the U.S., in the U.K., in Australia, in New Zealand, and in Canada. We have found them at all levels: national, state, provincial, and local. Why? Because these are the levers that change the framework within which organizations and people work. "It is usually not possible to command large organizations to make painful changes in long-settled routines," explains Ted Kolderie, one of the reformers who brought public school choice to America. "It is possible, however, to redesign the institutional arrangement in which they operate, so that they come to perceive these changes as necessary and desirable, in their own interest."

Business professors Michael Beer, Russell Eisenstat, and Bert Spector made the same point in a 1990 *Harvard Business Review* article titled "Why Change Programs Don't Produce Change":

> *Most change programs don't work because they are guided by a theory of change that is fundamentally flawed. According to this model, change is like a conversion experience. Once people "get religion," changes in their behavior will surely follow. . . . In fact, individual behavior is powerfully shaped by the organizational roles people play. The most effective way to change behavior, therefore, is to put people into a new organizational context, which imposes new roles, responsibilities and relationships on them.*

Dan Loritz, one of Kolderie's co-conspirators for public school choice in Minnesota, uses an agricultural analogy. "A farmer goes out and spends a lot of time making sure that the fields are just right, gets all of the weeds out, plants the corn with great care, puts enough herbicides on it to make sure that there aren't any weeds, and hopes that there's enough water," he says. "And if everything is right, the corn grows all by itself."

Reinventors should think like farmers, Loritz argues. If they create the right conditions, the results will follow.

Rewriting the Genetic Code

To extend the agricultural metaphor, think of public systems as organisms: complex, adaptive systems that live, grow, change over time, and die. Organisms are shaped by their DNA: the coded instructions that determine who and what they are. DNA provides the most basic, most powerful instructions for developing an entity's enduring capacities and behaviors. Change an organism's DNA and new capacities and behaviors emerge; change enough of the DNA and a different kind of organism evolves. Usually organisms change very slowly, as their DNA randomly mutates and some of these mutations make them more successful in their environments.

The same is true for public systems: normally they evolve very slowly. Bureaucratic public systems were designed to be stable. But we have reached a point in history where this stability is counterproductive. In today's fast-changing, globally competitive information age, systems that cannot change are doomed to failure. They are like the dinosaurs, which could not evolve fast enough to survive when their environment changed.

In this situation, the solution is genetic engineering: change the system's DNA. Our research tells us that the most fundamental pieces of public sector DNA are those we have discussed in our story of British reinvention—a system's purpose, its incentives, its accountability systems, its power structure—and one other we have not yet discussed, its culture. Successful reinventors have all stumbled across the same basic insights: that underneath the complexity of government systems there are a few fundamental levers that make public institutions work the way they do; that these levers were set long ago to create bureaucratic patterns of thinking and behavior; and that changing the levers—rewriting the genetic code—triggers change that cascades throughout the system.

There are many ways to categorize these fundamental levers of change. We have grouped them into five basic strategies, each of which includes several distinct approaches and many tools. For each lever, we have designated a strategy. And to help people remember the strategies, we have given each one a label that begins with the letter *C*.

The Five C's

Lever	***Strategy***	***Approaches***
Purpose	Core Strategy	Clarity of Purpose Clarity of Role Clarity of Direction
Incentives	Consequences Strategy	Managed Competition Enterprise Management Performance Management
Accountability	Customer Strategy	Customer Choice Competitive Choice Customer Quality Assurance
Power	Control Strategy	Organizational Empowerment Employee Empowerment Community Empowerment
Culture	Culture Strategy	Breaking Habits Touching Hearts Winning Minds

The Core Strategy

The first critical piece of DNA determines the *purpose* of public systems and organizations. If an organization is unclear about its purpose—or has been given multiple and conflicting purposes—it cannot achieve high performance. As Yogi Berra is reputed to have said, "If you don't know where you're going, then any road will take you someplace else."

We call the strategy that clarifies purpose the *core* strategy, because it deals with the core function of government: the steering function. While the other four strategies focus more on improving rowing, the core strategy is primarily about improving steering. It eliminates functions that no longer serve a valid public purpose or that can be better done by the private sector or another level of government. It uncouples steering from rowing (and service from compliance), so each organization can focus on one purpose. And it improves government's ability to steer by creating new mechanisms to define goals and strategies. (For more, see part II,chapters 4-7.)

In the U.K. for example, Margaret Thatcher's first effective strategy was privatization of functions that were better left to the private sector. The Next Steps initiative then uncoupled steering and rowing, helping departments focus on policy and direction and agencies focus on service delivery or compliance.

The Consequences Strategy

The second key piece of DNA determines the incentives built into public systems. Bureaucratic DNA gives employees powerful incentives to follow the rules and keep their heads down. Innovation can only bring trouble; the status quo brings steady rewards. Employees are paid the same regardless of the results they produce. And most organizations are monopolies—or near-monopolies—that are insulated from their failures. Unlike private firms, they do not lose revenues or go out of business if the competition does a better job.

Reinventors rewrite the genetic code to change these incentives, by creating *consequences* for performance. When appropriate, they put public organizations into the marketplace and make them dependent on their customers for their revenues. When that is not appropriate, they use contracting to create competition between public and private organizations (or public and public organizations), as the British did through market testing and compulsory competitive tendering. When neither is appropriate, they simply measure performance and create consequences (both positive and negative), as the British did with their Next Steps agencies. Markets and competition create much stronger incentives and therefore greater performance improvements, but not all public activities can be put into competitive markets or competitive bidding. (For more, see part III, chapters 8-12.)

The Customer Strategy

The next fundamental piece of system DNA focuses primarily on *accountability*, specifically, to whom are the organizations accountable? (To be precise, all five strategies touch on the issue of accountability. The core strategy defines *what* an organization is accountable for; the consequences strategy determines *how* it will be held accountable; the control strategy affects *who* will be accountable; and the culture strategy helps employees internalize their accountability. But by making organizations accountable to their customers, the customer strategy deals most powerfully with the issue of accountability.)

Most public entities are accountable to elected officials, who create them, determine their functions, and fund them. Because these officials are under constant pressure to respond to the demands of interest groups, they often care more about where public resources are spent than about the results they purchase.

In response to widespread abuses by politicians, bureaucratic reformers long ago established a professional civil service to insulate the management of departments from political influence. Managers and employees gradually became accountable for following the rules of the civil service. Hence managers are held most tightly accountable for following these rules and for spending their funds as appropriated by elected officials. Rarely is anyone held accountable for the results.

The *customer* strategy breaks this pattern by shifting some of the accountability to customers. It gives customers choices of service delivery organizations and sets customer service standards those organizations must meet. In the U.K., Major's Citizen's Charter put the customer strategy into play.

Creating accountability to the customer increases the pressure on public organizations to improve their results, not just to manage their resources. It creates information—customer satisfaction with specific government services and results—that is difficult for elected officials, public managers, and employees to ignore. And it gives public organizations the right target to shoot at: increased customer satisfaction.

This does not mean that public organizations are no longer accountable to their elected representatives; it means they often have dual accountability. As we explain in part IV, chapters 13-15, this works best when elected officials align these dual accountabilities by stating their goals in terms of customer satisfaction and holding organizations accountable for meeting customers' needs.

Nor does the customer strategy suggest that the role of customer supplants that of citizen, as some critics argue. Both roles are important. Citizens vote, influencing the policies set by their representatives. Public organizations then implement those policies. But in bureaucratic systems, citizens have no practical way to hold those organizations accountable for their performance—or even to give them feedback on their performance. The customer strategy puts them in the feedback loop.

The Control Strategy

The fourth critical chunk of DNA determines where decision-making *power* lies. In bureaucratic systems, most of the power remains near the top of the hierarchy. In democracies, power first flows from citizens to elected officials; then from elected officials to central "staff" agencies such as budget and personnel offices; finally from those central control agencies down to agency ("line") managers. Typically, elected officials keep as much power as possible in their own hands, and the central control agencies guard their power even more jealously. Line managers find their options limited and their flexibility constrained by detailed budget instructions, personnel rules, procurement systems, auditing practices, and the like. Their employees have almost *no power* to make decisions. As a result, government organizations respond to new orders rather than to changing situations or customers' needs.

The control strategy pushes significant decision-making power down through the hierarchy, and at times out to the community. It shifts the form of control used from detailed rules and hierarchical commands to shared missions and systems that create accountability for performance. It empowers organizations by loosening the grip of the central control agencies—as the U.K.'s Treasury Department did in response to the success of the Next Steps agencies. It empowers employees by pushing authority to make decisions, respond to customers, and solve problems down to those with frontline knowledge—as some executive agencies have. Some reinventors use a third approach: they shift control from public organizations to the community, empowering community members and organizations to solve their own problems and run their own institutions. Margaret Thatcher did this when she sold 1.25 million public housing units to tenants and gave control over schools to community-based governing bodies. (For more, see part V, chapter 16-19.)

The Culture Strategy

Finally, the last critical piece of DNA determines the *culture* of public organizations: the values, norms, attitudes, and expectations of employees. Culture is shaped powerfully by the rest of the DNA: by an organization's purpose, its

incentives, its accountability system, and its power structure. Change these and the culture will change. But culture does not always change just as its leaders would wish it to. At times it will harden into resistance and resentment. Often it will change too slowly to satisfy customers and policy makers. Hence we have found that virtually every organization that has used the other four C's has eventually decided it needed a deliberate campaign to rewrite the genetic code that shaped its culture. We have not discussed these efforts in the U.K., but we found them in every organization we visited.

Bureaucratic systems use detailed specifications—functional units, procedural rules, and job descriptions—to mold what employees do. They make initiative risky. As employees become habituated to these conditions, they become carriers of the culture. They become reactive, dependent, fearful of taking too much initiative themselves. In this way, bureaucratic DNA creates cultures of fear, blame, and defensiveness.

Reinventors use three approaches to reshape the culture; they mold the organization's habits, hearts, and minds. They develop new habits by giving people new experiences—new kinds of work and interactions with new people. They reinforce these new behaviors by helping people shift their emotional commitments: their hopes, fears, and dreams. And they support this new emotional covenant by building a shared vision of the future, a new mental model of where the organization is going and how it will get there. (For more, see part VI, chapters 20-25.)

Increasing Your Leverage

Most reinventors start with just one or two strategies in mind. Inevitably, they discover the need for another, then another, until they are using all five. Why? Because using only one or two strategies does not give them enough leverage. Any one strategy is to reinvention as rain is to farmers: indispensable but not sufficient. Farmers also need seeds. rich soil, adequate fertilizer, and sunshine. If all five of these elements are aligned with one another, the crops grow.

One way to put multiple strategies into play is to use what we call "metatools." They are like MIRVs—missiles that deploy multiple warheads. For example, the Next Steps initiative combined the core, control, and consequences strategies. School choice systems in which money follows the child combine customer and consequences. Total quality management and business process reengineering deploy elements of the customer, control, and often culture strategies. (For more on metatools, see chapter 24.)

Indeed, you will find that the five strategies often overlap. Some tools, like customer councils or performance management systems, implement only

one strategy. But just as many involve multiple strategies. It is only natural, for example, to combine the uncoupling of steering and rowing (core) with a performance contract (consequences) and more flexibility for rowing organizations (control)—as the British did. (We have dubbed this metatool, which we will discuss further in chapter 7, a "flexible performance framework.") Similarly, it is only natural to combine customer service standards (customer) with rewards and penalties for organizations that succeed or fail to meet those standards (consequences).

It is so natural to combine two or three strategies in one tool, in fact, that the boundaries between strategies can get very blurry. We have separated the strategies to give you a clear conceptual framework you can use to think through possible strategies, approaches, and tools. In our experience, reinventors have found a clear map of the basic levers immensely helpful. It makes them aware of all their options and helps them fill in their blind spots. In practice, however, multiple strategies are often joined at the hip—as they must be to yield maximum power.

But Will the Five C's Work Here?

Some of you may be saying to yourselves, "This all sounds logical, but it will never work here. My city (or county, or province, or country) is different." Your government may not be *ready* to reinvent, but when it is, rest assured, these strategies will apply. They work in small cities and large nations, in parliamentary systems and presidential systems, in strong mayor cities and council manager cities. Purpose, incentives, accountability, power, and culture are the fundamental DNA of every public system we have examined.

The appropriate *tactics* differ in different political systems. In a Westminster parliamentary system like that of the British, Australians, New Zealanders, and Canadians, the party (or coalition of parties) with a majority in Parliament also leads the executive branch. In American terms, it is as if only one house of Congress really matters, its majority leader is president, and its leadership forms the cabinet. Therefore parliamentary systems avoid the squabbles between the executive and legislative branches that so often paralyze American governments. Ministers can decide on a course of action and make it happen—quickly.

This has an enormous impact on the tactics reinventors choose, how fast they go, and how much they take on. It means they must spend less time organizing political support for their reforms than their American counterparts. And it means they tend to start in different places than Americans do: they can often go straight at large-scale systemic reform, using the powerful but controversial core and consequences strategies. American reinventors, in contrast, often start with the "softer" strategies of control and culture to avoid political disputes.

Similarly, the council-manager form of local government creates more separation between elected officials and managers than the strong mayor form. This makes it easier for elected officials to focus on policy and let managers handle administration. Nonpartisan elections and rational political climates also make it easier to reinvent, because political distrust and warfare between parties interferes less. In nonpartisan, council-manager environments, local governments tend to go straight at reinvention, changing basic systems and using all the strategies—much like their counterparts in parliamentary governments. In highly partisan, strong-mayor cities, reinventors more often try to stay out of the political limelight, using the less controversial strategies of control and culture and reinventing at a slower pace.

Different kinds of organizations require different approaches as well. There are four basic types of public organizations: policy, regulatory, service, and compliance. Service organizations deliver services. Policy organizations make policy decisions. Regulatory organizations set rules, and compliance organizations enforce them. (There is a fine line between these last two, and many organizations perform both functions. But as we will argue in chapter 4, it is usually best to separate them.) Regulatory organizations are actually a subset of policy organizations, because their job is to steer society by setting the rules, while compliance organizations row the boats. As some put it, service organizations deliver services, while compliance organizations deliver obligations.

These distinctions are important, because reinventors who work at the organization level must apply the five strategies differently in different types of organizations. This can be tricky, since many organizations perform a mix of functions. Often they combine policy and service functions, or regulatory and compliance functions. Many service organizations, from schools to public housing developments, must also win compliance with standards of behavior. Police departments are compliance organizations, but they perform services as well: guiding traffic around construction sites; performing crowd control at concerts; running youth sports programs. Many social benefit agencies, such as employment services and welfare offices, deliver services, write regulations, and enforce compliance with their rules. Tax collection agencies are in the compliance business, but they typically offer services such as information hot lines. And many policy advice organizations are actually service rather than policy organizations, because they provide services to policy makers, rather than making policy decisions themselves.

To make matters more complex, many organizations of one kind have units of another within them. Environmental regulatory and compliance agencies have personnel offices that provide services within them. Service organizations house compliance organizations, such as auditors' offices, inthem. Finally, while most public organizations serve "external customers," such as the general public or a particular community, others serve "internal customers"—other government units.

A Typology of Government Organizations

Organization Type	*Example*
Policy	Planning Office; School Board
Regulatory	Federal Communications Commission Securities and Exchange Commission
Service Delivery	
External Customers	Public Works Department School District
Internal Customers	Data Processing Office Maintenance Department
Compliance	
External Compilers	Police Department; Occupational Safety and Health Administration
Internal Compilers	Auditors; Inspectors General

The five strategies play out quite differently in policy and compliance organizations than they do in service organizations. In compliance agencies, for instance, the customer strategy is more complex. These agencies' primary customers are the public at large, represented by elected executives and legislators. But "compliers"—taxpayers, drivers, polluters—are also important. Then there are non-compliers: people and organizations that break the law, don't pay the taxes they owe, or ignore environmental regulations. Compliance organizations have to pay attention to all three categories.

Similarly, the control strategy plays out differently in compliance organizations. Because some compliance organizations, such as the police and courts, are normally required to treat every complier the same—or at least to treat similar classes of compliers equally—there are limits to how much flexibility they can allow their employees.

We will address these issues more fully as we discuss each of the strategies and approaches. For now, suffice it to say that reinvention applies to all types of organizations. Some people in regulatory and compliance organizations argue that reinvention is only about policy and service delivery, but this is at best an excuse for inaction.

None of these differences changes the basic levers that create fundamental change. In all public organizations and systems, the difference between isolated innovations and coherent reinvention is spelled s-t-r-a-t-e-g-y. If you want a qualitatively different kind of public system or organization, you must rewrite the genetic code. You can generate a series of innovations without using the five C's, but you cannot create a continuously improving, self-renewing system. Consider this the first rule of reinvention: *No new DNA, no transformation.*

Notes

All quotations that are not attributed in the text or in these endnotes are from interviews with the authors or their associates. Only in cases where there might be some confusion about the source of a quotation have we indicated in a note that it came from an interview.

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