Public Sector innovation: Why it’s different

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Introduction

This paper discusses the role of governance in public sector innovation. It follows an earlier paper in this series on the role of the board in innovation (Kay & Goldspink, 2016). However, this paper differs considerably from the first one in both nature and focus. What our research indicates is that the differences between innovation in the private and public sectors are vast. This paper seeks to critique common misconceptions about public sector innovation and calls for a new way of thinking about it. The paper draws on 3 studies we have conducted over the past 5 years, and illustrates some of the unique characteristics of the public sector that mean the way we approach innovation needs to fundamentally change.

The research that is used to inform the discussion includes:

• A study conducted for the AICD during 2014 (Kay and Goldspink 2015), involving interviews with over 100 Chairs of listed, private, public and not-for-profit boards; and

• Two studies conducted in 2012 involving interviews with 25 CEOs drawn from both listed and private sector organisations, as well as 25 Departmental Secretaries and Directors General drawn from both the federal and state public sectors. These latter studies were focused specifically on understanding executive views on what innovation means to them and involved identical methodologies in order to facilitate comparison between sectors (Kay and Goldspink 2012a, 2012b).

As with all areas of management practice, innovation in the public sector has been characterised by a tendency toward outsourcing and the adoption of private sector management principles. It is driven by the belief that the acquisition and development of private sector models in the public sector will improve the public sector’s ability to deal with a changing and more uncertain environment (Windrum, 2008). While not without its critics (Pollitt, 2000), this approach attained dominance through the 1990s and remains a major influence today.

More recently, extensions to the NPM have also emerged, including notions of ‘joined up government’ and the network focused ‘New Public Governance’ (NPG). The latter paradigm places public administration in the role of ‘meta-governance’, managing a mix of bureaucracy, markets and networks. Hartley (2005), for example, describes NPG as highlighting the need for increased collaboration, both within government and with external stakeholders, and again building on private sector ideas.

The context created by these trends is important to our discussion as they have significantly influenced the commentary and thinking about innovation in the public sector, leading to a number of unquestioned assumptions. Primary among these is the assumption that private sector ideas and models are equally applicable in the public sector. Multitudes of reports from both Government and academia advocate the adoption of private sector approaches, despite an almost total lack of empirical evidence to support such a position.

Based on the interviews we have conducted that directly compare the sectors, we argue that the above assumption, far from being supported, is counter productive to innovation in the public sector and a different (public sector specific) approach is needed. This presents a considerable challenge for governance.
The orthodox view

Innovation in the public sector has received increasing levels of attention in recent years. To some extent this has been driven by a view that, in general, the public sector is not as innovative as it should be. This perception is reinforced in the research literature, with the public sector globally characterised as conservative, bureaucratic and reluctant to change (Borins, 2002; Mulgan & Albury, 2003:5; Wise, 1999:150). This position has, however, been questioned, with several authors arguing it is a view that is either unsubstantiated or simply incorrect (see for example Gray, Broadbent & Hartley, 2005:7; Walker, 2007).

In this context, numerous researchers have commented (Koch, 2005; Langaraard & Scheuer, 2009; Borins, 2001; Mulgan & Albury, 2003; Hartley, 2005) on the differences between public and private sector innovation. The conjectured differences cover a series of recurring themes:

- The public sector lacks the market impetus to innovate that characterises the private sector;
- The public sector attracts people who are more risk averse, resulting in a more conservative and risk averse culture;
- The leadership in the public sector is held by the democratically elected representatives not the organisational head as it is in the private sector.

Before exploring the implications of these themes for innovation governance, it is important to clarify what we mean by ‘public sector’. There are a wide variety of public sector organisations with different governance arrangements. These include government departments, government owned entities, and government-funded organisations. Some report directly to a Minister, some have governing boards, some have advisory boards, and some have representative boards.

Where boards do exist, they have different dynamics in terms of how the members of the board are appointed, their responsibilities and powers. These variations have significant implications for innovation and its governance.

The role of market impetus

A common point of view is that the public sector is less innovative than the private sector because the private sector innovates within a market context that provides a greater impetus to take risks (Potts, 2009; Bhatta, 2003). We would argue that, in many ways, this perspective is an oversimplification that, in part, misconstrues the diverse nature of today’s public sector as well as differences in the risk dynamic involved.

The public sector is innovative, but the nature and form of that innovation is different to the private sector, and arises from fundamental differences in the two sectors’ measures of success. The market provides the private sector with a greater range of possibilities to extract reward from the risks it takes. The private sector can undertake a portfolio approach to this risk, on the basis that it can ‘net out successes and failures’ (Bhatta, 2003). The failed ideas can often have limited downside, and can be compensated (financially) through the success of other ideas, such that on balance the organisation comes out ahead. While stakeholder related risks exist for the private sector, it can be argued they have less impact than in the public sector, a point that will be expanded on below.
Perhaps most importantly, the private sector doesn’t need to get innovation perfect for it to be a commercial success. Indeed, the notions of first mover advantage and speed to market are predicated on a new innovation being ‘good enough’. Perfection can and often does come later. By contrast, the level of public and media scrutiny under which the public sector innovates – due to it being in the business of producing public good – is inevitably and significantly higher. ‘Good enough’ in the public sector is not ‘good enough’ if it involves even a small adverse impact and an associated negative news headline. The political outcry in relation to the Pink Batts Scheme is a prime example of this phenomenon, even though the scheme delivered against its objectives. So the rewards for public sector agents are arguably low or nil, while the risks for even small mistakes have very real, immediate and lasting (political) consequences.

It could be argued that quasi or fully-commercialised government owned enterprises are open to the influence of markets and that, as a consequence, private sector models of innovation should apply. Indeed, it was in an attempt to ‘get the best of both worlds’ that led to the formation of many such entities. In some instances, the intended benefits in terms of enhanced capacity to innovate may have been realised. However, as the State Bank of South Australia failure and the subsequent fall of the Bannon Government made clear, even when Governments adopt an arms-length stance and incorporate governance mechanisms identical to the private sector, this does not necessarily mean that there is no political accountability for perceived malpractice and/or losses against the public purse.

Arguing that the public sector should take more risks in order to be innovative is to ignore the context in which the public sector operates. In effect, the public sector adopts the risk appetite of its stakeholders – the public – and broadly speaking, their risk appetite is close to zero when it comes to the expenditure of public money. This situation drives a different risk dynamic in the way risks present themselves and a different risk culture in terms of how they are engaged with.

However, the public sector has other resources available to it that are not available to the private sector. The most significant of these resources is (potentially) time. Taking an extra six months to perfect an innovation in the private sector could result in a significant loss of market share. Taking an extra 6 months in the public sector could mean the difference between a successful new initiative and a media scandal. Often the private sector will be rewarded for speed, while in the public sector the reverse can often be true.

Therefore, to describe the public sector as risk averse due to a lack of market impetus is an oversimplification. The risk appetite is set by the environment in which it operates and the risk-reward relationship that exists – the market is only part of this. The challenge is as much structural as it is cultural and to suggest, as some commentators have, that the public sector could innovate more if it took more risks is unproductive and unlikely to lead to improvement.
Who is the leader in the public sector?

Apart from the differences in market structure, the greatest difference between the public and private sectors is the role of the organisational head. In the private sector, the CEO tends to set the style for innovation. As discussed in our previous paper, the innovation style of the CEO provides a key touch point for the board’s innovation governance. Again, the diversity of forms that public sector organisations may take, and variations in the structural relationship between the CEO and board, create a range of alternative scenarios for how this style may emerge. Government owned entities can potentially display a similar dynamic to the private sector, but with the exception that board members are usually political appointments. In the context of Government departments, however, there are two governance hierarchies operating in concert: the government executive (Secretary or Director General) and the board. While the academic literature acknowledges this distinction, there is scant discussion on the implications this has for innovation, let alone innovation governance. However, as we will see below, this difference has profound implications for public sector innovation.

The twin governance hierarchies also have significant implications for the role of public sector boards in the broader organisation. While the board can influence the appointment of the Secretary, often they don’t have the power to select them. Typically the Minister appoints the Secretary or DG, and depending on the form of the public sector board, also appoints the members of the board itself. Apart from the obvious implications this has for notions of independence, this structure gives rise to two parallel systems of innovation within Government departments that often need to be managed through a single organisational structure.

For want of better terms, we will describe these systems as:

- ‘Departmental’: innovation that occurs within a department and has been initiated internally and led internally by the Secretary and/or their executive, and;
- ‘Ministerial’: innovation that occurs through interaction with and on behalf of the government’s political appointee, sometimes referred to as the political layer in the literature.

Potentially the board could/should be engaged in both, as both come together to drive the actions of the department. These different innovation systems make direct comparison with the private sector both difficult and potentially misleading. While ‘Departmental’ innovation arguably has some similarities with the leadership dynamic experienced in private sector organisations, it can often be distorted by the needs of ‘Ministerial’ innovation.

To illustrate these differences, the next section will examine the results of comparative research we conducted in 2012.
What does the data reveal?

We collected 84 usable stories of innovation from the CEOs and APS leaders in our sample – 42 of success and 42 of failure. As the stories were drawn from a wide variety of industries and different areas of the public sector, using industry specific definitions of innovation to classify the different stories wasn’t appropriate. To address this issue and enable a comparison between sectors, we looked for the common contextual factors that played a role in the leaders’ stories and influenced their motivations.

To this end we identified two key dimensions:

- **The Level of Uncertainty** the CEO/Secretary held about both their organisational situation and the environment it was operating in;
- **The Level of Pro-activity** inherent in the CEO/Secretary’s story. Was the innovation part of a planned strategy or a response to an external trigger that needed to be incorporated?

Each of the 84 innovation stories were given a score out of ten for both dimensions and plotted (see Figures 1 and 2 on page 8), so that they could be grouped and compared. Both the CEOs and Departmental Secretaries were given complete freedom to choose what story they told, and so, presumably, told the stories that for them best represented what innovation success and failure looks like.

When we consider the differences between Figures 1 and 2, the first observation is the near absence of private sector stories from the lower right of Figure 1. This corner is characterised by high levels of uncertainty and a reactive stance on the part of the CEO/organisation. We would suggest that the reason for a lack of stories in this quadrant is that a private sector CEO who finds themselves in this situation has to respond to an effectively unforeseen or significant disruption to their business. As such they may be unlikely to survive in the role, even if the organisation survives, whatever the disruption is.

By comparison, the public sector (Figure 2) had a number of stories in the lower right quadrant, though all of them were failures. Indeed, some of the Secretaries commented that they would expect a large proportion of public sector innovations to be in that quadrant. This draws attention to the distinction between reactive and proactive innovations in the public sector, as the difference between them is dramatic. There was only one successful innovation identified from a reactive context in the public sector. By comparison, whether a private sector CEO was reacting to an organisational circumstance or proactively innovating, there was little difference in their likely success or failure rate.

It is also interesting that the success rate for reactive innovations appeared to be unaffected by the relative complexity or uncertainty of the idea. Indeed, the public sector identified more successful innovations involving high uncertainty, suggesting a well-developed innovation capability when the circumstances are right. One explanation for the pattern we see in the data relates to the interaction of the two innovation systems described above.

When the data is reviewed in terms of the distinction between ‘Departmental’ and ‘Ministerial’ innovation, a large proportion of reactive innovations were drawn from the ‘Ministerial’ layer. Given we interviewed Heads of Department for the study, it is unsurprising that these failed innovations took on a reactive stance – as the ‘Departmental’ innovation system was being forced to react to (or accommodate) a ‘Ministerial’ innovation. This latter form of innovation tends to be far more politically sensitive and can often lack the contextual sensitivities of ‘Department’ driven innovations. It is reasonable to argue that a Department should be able to take a policy idea and turn it into a successful innovation. The question then arises, why does this seem relatively rare in our sample?
In comparing public and private sector innovation, this political dynamic presents a significant point of difference between the two sectors, and in our view seriously calls into question the assumed relevance of private sector innovation models in the public sector. It therefore also impacts on the role of the board.

Figure 1: Plot of private sector innovation stories

Figure 2: Plot of public sector innovation stories
Implications for innovation governance

The discussion above brings into focus the importance of the relationship between the Minister and the Department, and the impact this can have on innovation. To the extent that departments find they are handed both the ‘what’ and ‘how’ for new policies or programs, the scope for delivery agencies to use their expertise and familiarity with the complexities of the environment is constrained – leaving them with few or no means for managing the uncertainty inherent to an innovation.

Worryingly, a significant minority of the Secretaries interviewed described a shift towards a more reactive stance in the public service over the past decade. This may be associated with the shift towards greater ‘contestability’ of advice and the growing role of ministerial advisers in influencing not only the intent of policy but also the mechanisms by which it is pursued. The change has also been amplified by the increased politicisation of the public service. Peter Shergold (former Secretary of the Department of Prime Minister and Cabinet) cites the argument of Melbourne Age journalist Kenneth Davidson that creative tension, long a tradition between Ministers and senior bureaucrats, has been destroyed: “Now, when the government says, ‘Jump’, the response of the bureaucracy is ‘How high?’” (Shergold 2004). This undermines the tradition of ‘ frank and fearless’ advice. Shergold does not necessarily endorse this view but it is increasingly widely held.

Whatever the reason, this trend towards reactivity is important because it suggests that the number of reactively driven innovations is at the least going to stay the same but more likely going to rise, and it is this area of public sector innovation that suffers the most. Therefore, a key role for public sector boards should be to help moderate the more negative effects of ‘Ministerial’ innovation, to ensure the Department or delivery agency is allowed to manage down the uncertainty associated with an idea in a systematic way. This includes helping all parties be clear about the intended policy outcomes while retaining maximum scope for the Department to innovate around the means for delivering against those outcome.

Despite best intensions, however, such moderation is not easy. As one Chair, noted in relation to an attempt to achieve this type of moderation before budgets were set: [Chair 62]: The Chairman went and saw the Minister a few times and suggested. But … there was a pretty strong government advisor driven position. So, “I hear what you’re saying, and it’s very nice, but we’ve decided”. What’s the term – it’s ideological. They’d just decided this was the way it was going to be, and off they went.”
Timing is also a critical factor impacting on the board’s ability to influence:

[Chair 72]: ‘Now policy in a government organisation like this is a difficult one, because policy with a big P isn’t set by us, … Sometimes policy is erratic, particularly around election time, I have to close the board down occasionally; this is life. Sorry, it’s really difficult, but if you think I’m going to tell the Minister he’s wrong seven weeks out from the election? … I’ll get about 30 seconds, 25 of that will be him man handling me out the door.

So there are clear limits to the level of influence a public sector board may have (though generalisations are very difficult to make due to the variety of board types).

The increased use of boards as part of the overall governance structure in public administration was itself a product of the NPM reforms of the 80s and 90s. Unlike the private sector, where board structures tend to be variations around a central theme or model, in the public sector there is a wide range of forms with varying influences and responsibilities. In the interviews with Chairs it was clear that the relationship between the board, the Minister’s office and the Secretary varied greatly depending on whether:

• The Board and or the Department Head were political appointees;
• The Board was constituted as representative of stakeholder constituencies;
• The Board was advisory in nature rather than taking responsibility for strategic direction and stewardship.

The role can also differ depending on whether the agency is budget funded, fully or quasi autonomous. As such, Rhodes has argued ‘What is clear is that there is no agreement on either the stewardship role of the civil service or on the appropriate relationship between ministers and civil servants.’ (Rhodes 2014: 11). In many ways, a public sector board can find itself in the middle of the relationship between the two.

As a consequence, the capacity of a public sector board to intermediate and support conditions conducive to effective innovation is highly variable. In the case of some boards, it is likely there simply isn’t any scope to act.

The first point to recognise, however, is that the public sector is different, and what may work or be possible in a private sector context will not have the same effect in the public sector. Some of the Chairs acknowledged this in their interviews. For example one Chair noted:

[Chair 13]: ‘… government organisations operate in a very different environment to the private sector … I think there’d be a lot of private sector managers and boards that were very challenged by things like, “We’ve got this great new idea. We’d done our research. We think this is a great thing to do but we need some more capital.” … In, the public sector, that involves convincing a government to give you more money. You might have the best idea in the world to, to make extraordinary leaps in your outcomes and, and you will not get that … for government policy reasons. Nothing to do about the merit of the case; it’s all about, you know, fiscal restraint blah blah blah. “Here’s the general rule. Applies to everyone. Doesn’t matter how clever your idea is, you’re not going to get it.”’
In other agencies or circumstances, however, a clear definition of roles had emerged, such that the board could provide a key intermediating voice to offset the constraints on CEOs and Departmental heads. As one Chair observed:

[Chair 34]: … as it turns out in [a large Federal Government Agency], a not listed public company, the rules are that, … [the CEO] really can’t say anything too controversial about a government decision. But I’m apparently not subject to those rules. So that’s okay. So we have an arrangement where I’ve absolutely been saying what I need to say publicly … And that’s my role to do that. It’s [the CEO’s] role and [that of the] leadership team, however, to execute.

In many circumstances, the board does not have responsibility for hiring the Department head and the Department Head may not even report to the board.

[Chair 34]: … the CEO did not report to the board, or the Director General of the Department should I say. In effect when you looked at the constitution and cut through all the waffle, we were an advisory board. So you’re there with the stroke of a Minister’s pen, and when things are good, he or she will take all the credit, and when things go bad, “You’re all fired.” … we all know that that’s the game, and there’s a happy medium in the middle there, where with some Ministers you can start to … work with them well.

As such, a distinction needs to be drawn between public and private sector governance. Where private sector boards may use their ability to select or retain a CEO in order to influence the style of innovation within the organisation, in the public sector that positional power is largely absent. As such, innovation governance cannot be facilitated directly but takes the form of a gentler influencing. In an earlier paper in this series (Kay & Goldspink, 2015), we argued that a key role for private sector boards in innovation was to ensure alignment between the style of innovation of the CEO and the innovation needs of the organisation having regard to its circumstance. This approach would be difficult in the public sector.

In the context of a Government Department, a board has two people setting the tone for innovation - the Minister and Department Head. They have different responsibilities and may be more or less aligned in approach. The board, in most cases, will have fairly limited influence over the Minister, though, arguably, some influence can be achieved if the timing is right and the relationship properly developed. The Department Head will have their own style of innovation that they try to support within the department. However, this style will likely be disrupted by the political layer above. The board’s role is to help reduce this disruption, by supporting department driven innovations upwards, and moderating Ministerial innovations travelling downwards.
Conclusion

In our 2012 study, we attempted to compare innovation styles between the public and private sectors. However, it became clear that not only were the styles different, but, in fact, a direct comparison would be misleading. The dimensions or patterns that composed the private sector CEOs stories were fundamentally different from those of the public sector Secretaries. From a research point of view, the appropriate style of public sector innovation, given a particular circumstance, remains unknown.

Similarly, the role of the board in public sector innovation governance is also very different. It has to address very different challenges, and has very different levers with which to do this. As a result the process is more subtle and indirect than that of the private sector.

In the words of one Chair:

[Chair 72]: … I see good governance almost being, it’s not the machine, it’s not the people in the machine, it’s the oil, it’s the lubricant, that … provides the ability for an organisation to run smoothly and in the right direction, rather than in a dysfunctional way.
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