

# Beyond Reform to Performance Leadership in the Public Sector

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**Abstract**

The 1987 reforms delivered a step change improvement in New Zealand's public sector performance. At their core, the reforms caused a pervasive shift in mindset from the expenditure of resources (inputs) to the production of goods and services (outputs). Ministerial choice of services caused dramatic and sustained changes in behaviour throughout the sector. The opportunity to build on this base and make a further shift from outputs to performance leadership through government intervention (outcomes) is now being tackled. This shift will require the public sector to develop new competency in understanding the systemic impacts of interventions. The State Services Commission is tackling this through a wide range of projects including a systemic review of accountability arrangements that are at the heart of the current system of organisation. This paper reports on the lessons from a preliminary project conducted in July 1998. The project was not designed to provide answers; rather it raised questions and proposed lines of future inquiry that would inform the design of an improved public sector system.

Note: the views expressed herein are those of the authors. They should not be taken to express or imply any official policy on the part of either the State Services Commission or the New Zealand Government.

## Introduction

### Purpose

During 1998, the State Services Commission (SSC) conducted a project that used a systemic approach to learn about the dynamic behaviour of New Zealand's system of public management. The project had a particular focus on the mechanisms for establishing and maintaining accountability that are a key feature of the New Zealand system. This paper reports on some of the results of the project.

The chief objective was to trial a relatively untested approach (in this context) in the hope that it would start a dialogue offering new insights about the functioning and performance of the system. This in turn could assist the design of performance enhancing improvements to the system over time. It is in this spirit that this paper has been written.

### Background

The widely recognised success of New Zealand's public sector reforms provides a solid foundation for ongoing performance improvement across the sector. Beyond the reforms being entrenched in legislation, the purchaser/provider system of structuring and managing the public sector has been embedded into the culture of the public sector through the design of post-reform administrative process and procedures.

The language of government reflects these changes, particularly when referring to ministers as "customers" who purchase "outputs" from their Public Service departments. Strong adherence to the principles underpinning these reforms<sup>1</sup> has enabled change to be clearly explained, and resistance to be overcome. Most commentators agree that the public sector has, as a consequence, been significantly improved.

There is however, some perversity in this success. In some quarters, the diligent and strict adherence to the distinctive mid-1980's principles and practices of reform has worked against ongoing development of public sector management. In practice, it can be observed that, contrary to expectations, the system sometimes seems to function in ways that work against the logic of the reforms. Attempts to 'correct' or improve its performance do not always have the desired effects. Importantly, as the system evolves and new features are added, a system that is intended to be elegant in theory has grown cumbersome in the complexity of its reality.

The strong commitment to the reforms has meant that questioning their unintended consequences may be viewed as counter-productive. There is a need to develop a more inquisitive approach in the interests of long term improvement.

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<sup>1</sup> The theory behind New Zealand's public management reforms was constructed upon a combination of agency theory, public choice theory, managerialism, and transaction cost economics (see Boston *et al*, 1996).

## **Establishing a ‘systems’ project**

### **Project focus<sup>2</sup>**

The use of contractual instruments is one of the cornerstones of New Zealand’s public management model<sup>3</sup>. They are used to specify what ‘outputs’ ministers will ‘purchase’ from departments each year, and how the Government’s interests as ‘owner’ of Public Service departments will be managed. This arrangement gives departmental chief executives a high degree of managerial discretion over the development and deployment of their organisations resources and capabilities.

Following the adoption of a “quasi-market” approach to the production of public goods and services, a system for identifying and managing achievement of the Government’s ‘Overarching goals and Strategic Priorities’ (the Strategic Priority/Key Result Area system) was added to the model in the 1990’s. Instruments for managing what is known as the Government’s ‘ownership’ interests in its agencies have also had to be developed. Ownership encompasses a broad range of strategic organisational performance and capability issues that cannot be classified as outputs, and thus are not easily contracted for in quality, quantity, timeliness and cost terms.

Concomitant with the freedom to manage that this was intended to give bureaucrats, the need for a highly developed, and resource intensive, accountability regime was also seen to be essential for maintaining transparency and confidence in the Public Service. However, it imposes a considerable organisational overhead on departments, and attracts criticism over the impact it has upon their performance and behaviours.

In 1998, the State Services Commission began to examine this regime, with the objective of designing a clearer, more streamlined, and more effective accountability framework. The intention was to enable chief executives to link internal planning and accountability processes and systems in their departments to external accountability requirements, as well as giving increased attention to longer-term strategic and ownership issues.

### **Why use a “systems” approach?**

As part of this process it was decided to trial the use of systems analysis, or systems thinking, techniques. This approach was used to provide an alternative to traditional policy analysis tools, and offer new insights into the functioning of the system. The State Services Commission (SSC) expected to develop and document an enhanced understanding of the dynamic operation of the public management system (with particular emphasis upon the accountability sub-system), as an aid to designing future improvements.

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<sup>2</sup> It should be noted that the project confined itself to considering only the core Public Service.

<sup>3</sup> In New Zealand, a key feature of the public management system are “purchase” and “performance” agreements that are annually agreed between a minister and a chief executive. These cover both the provision of outputs (in some detail) and some key aspects of departmental management.

A sense of public management as a system (rather than a static model) was, in fact, articulated very early in the reforms. A landmark Treasury briefing document noted that:

*“...achievement of improved management outcomes will only be possible if the system is treated as a whole”*

Importantly, The Treasury’s briefing stressed the need:

*“...to avoid piecemeal change that could weaken or distort the incentives of those given responsibility for management decisions to act in a way consistent with the objectives they have been given”* (The Treasury 1987).

New Zealand’s reforms have been internationally recognised for their unity of vision and coherence. Fundamental systemic change was introduced via the State Sector Act 1988, and the Public Finance Act 1989. However, in contrast to the coherence of the major legislative changes to the system, piecemeal change involving a steady accretion of administrative instruments has been a feature of the evolution of the system since during the 1990’s.. A good analogy for what has occurred is that, while reforming legislation aimed to arrive at a new general equilibrium solution for public management, administrative reform has generated partial equilibrium results.

In deciding to employ a systems approach, SSC argued that it was particularly warranted because:

- it challenges the dominant public management paradigm that is rooted in linear cause and effect reasoning;
- it has the capacity to cross specialist and/or managerial boundaries in organisations, and call into question established ways of structuring thought and action. In short, it challenges the status quo in organisations;
- systems analysis acknowledges that humans have a limited ability to identify and understand ( and therefore manage) complex and dynamic relationships; and
- with its requirements for different and holistic approaches to problem solving, systems thinking attempts to deal with the difficulties of a fuzzy, chaotic world.

Although not new, systems thinking has not been widely used (at least formally) in government for either system design or policy analysis. The key argument for applying this approach to the analysis of the public management system was that the system is complex, and cannot be adequately understood by focusing on one component at a time. Any future change to the system should be preceded by a robust practical understanding of how the system is functioning.

### **Applying a systems analysis approach**

Systems can be broadly categorised as hard or soft. Hard systems are characterised by their clear objectives, preponderance of technical issues, and ability to be optimised. In contrast, soft systems are dominated by human rather than technical issues and exhibit the following characteristics:

- multiple objectives that may be unclear or conflicting;

- multiple stakeholders who may have multiple or conflicting interests;
- no clear agreement on objectives; and
- complex inter-relationships between system elements that may or may not be well understood, or which may even be subject to dispute.

These soft system characteristics are evident in the New Zealand (or any other) public management system to varying degrees. Efforts to understand and shape the system's behaviour are conditioned by three important factors:

- the cognitive difficulty of arriving at an accurate, objective understanding of the system (as a basis for designing interventions) given its dynamic complexity;
- the underpinning logic of the reforms was heavily directed towards establishing behavioural incentives for individuals that would lead to desired system performance (rather than the previous approach of using detailed management controls to constrain behaviour); and
- the impact of variation upon the system (the degree to which actual system behaviour varies relative to assumptions about its normal, predicted or average behaviour).

These characteristics explain why the overall performance of the public management system is so difficult to predict, let alone optimise. Effective intervention into the public management system must be based upon a solid, contextually based, and dynamic appreciation of what is driving that system.

## **Analysis method**

### **1. Identify the manifest and extant systems, and the differences between them.**

An analytical framework that concentrated upon the differences between *manifest*, *extant* and *requisite* systems was developed (after Jaques, 1989).

Respectively:

- The manifest system refers to the system as it is documented (and therefore expected) to operate.
- The extant system refers to the way that the system is observed to operate in practice.
- The requisite system refers to the ways in which the system should be designed to produce the desired outcomes, based upon a clear understanding of that system's dynamics.

Using this framework, in the New Zealand there is:

- a manifest (theoretical) system embodied in such things as legislation; the Cabinet Office Manual; a raft of official directives, guidance and explanations about how things are done; and the documented knowledge/experience of public sector managers;
- an extant (actual) system that emerges out of the dynamic interaction of the various elements of the manifest system with its external environment; and

- potentially a requisite system that holds the promise of more effective public management.

After constructing a picture of the manifest system, the project team attempted to describe how the system, and its various sub-systems, actually functions. Simplified causal loop diagrams of the public management system, and its most important sub-systems (the accountability system, the strategic management (SRA/KRA) system, and the budget system) were developed. Reflection on the performance of these systems led to the development of three hypotheses about its design and behaviour that could be tested in interviews. One hypothesis covered the impact of the underpinning theory of the public sector reforms on system outcomes; a second addressed the effectiveness of system design in support achievement of Government objectives; while the third focused on the impact of the system on behavioural incentives.

## 2. Identify Systems Dynamics

Interviews aimed at testing the hypotheses were conducted with a range of public managers, former chief executives, academics and architects of the reforms. The results of the interviews were analysed, and key issues about the system were distilled from this material. System archetypes, (see Senge, 1992) were used as a means to understand and describe the dynamics of parts, or sub-systems, of the public management system that hypothesis testing had indicated were not functioning as designed or desired. From this, sets of propositions were put forward for ongoing discussion.

## Project findings

### The manifest system

The key finding was that the manifest system provides a sound foundation for future improvement. However, in-built tensions were identified in the accountability sub-system. The accountability sub-system relies on contractual or “held” accountability yet the “spirit of Public Service” is more attuned to “reasonable” accountability as illustrated in table 1.

<b>Table 1: Alternative accountability models</b>	
<b>Contractual Accountability</b>	<b>Reasonable Accountability</b>
<ul style="list-style-type: none"> <li>• Requires my boss to hold me accountable for the performance of my staff</li> <li>• Is built on lack of trust (Theory X) and in the extreme is contractual.</li> <li>• Can be constructed in a bureaucracy using task assignment, measures, performance review, and consequences</li> <li>• Requires exceptional leadership to avoid in-built undesirable consequences such as dull compliance</li> <li>• Requires a balancing loop of long term systemic thinking to moderate behaviour</li> </ul>	<ul style="list-style-type: none"> <li>• Is a precondition for “felt responsibility”</li> <li>• Allows me to choose to hold myself accountable for the outcomes I can exercise reasonable control over</li> <li>• Is built on trust and in the extreme is unenforceable (Theory Y)</li> <li>• Requires the design of a system that taps into individual values (e.g. Public Service ethic) and cannot be administered bureaucratically</li> <li>• Engenders good leadership through high expectations</li> <li>• Requires a control system to deal with individuals who attempt to corrupt the system</li> </ul>

## The extant system

Testing Hypothesis 1 (that the application of the theory underpinning the system Public Service has resulted in unintended consequences) broadly confirmed the hypothesis. The theory underpinning the public management system *has* produced unintended consequences, and the extant system behaves in ways that are not always consonant with the logic of the reforms. The application of this body of theory is not sufficient, on its own, to design a performance oriented public management system.

Testing Hypothesis 2 (that the design of the Public Service Management System adequately supports the government to achieve its stated objectives) highlighted that roles and relationships are central to achievement in the system (perhaps to a greater extent than the system of performance and output specification and monitoring). There are weaknesses in the design of the structures, roles and relationships, especially those at the centre of the system.

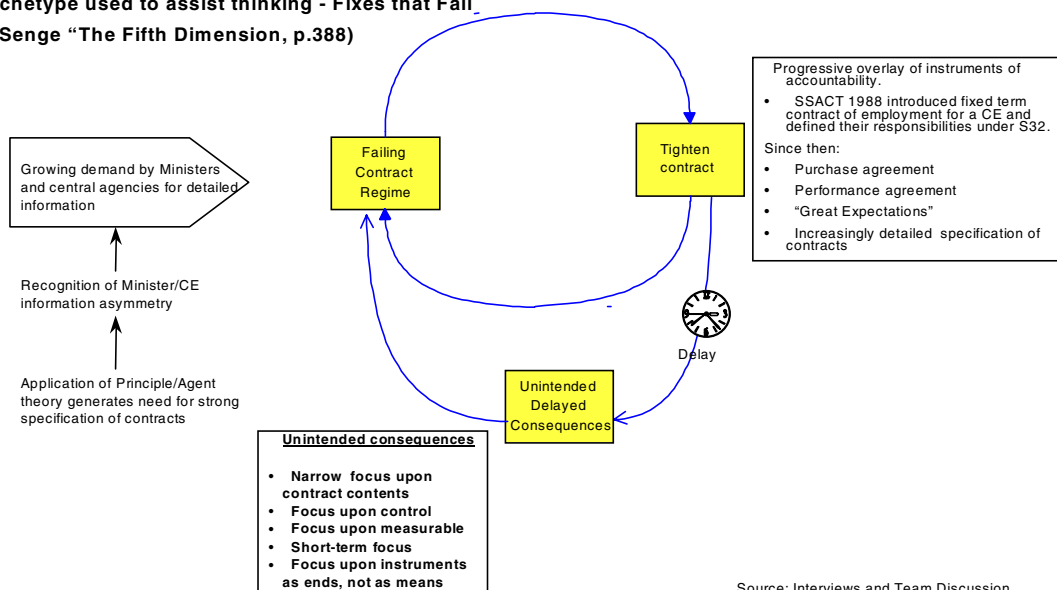
Testing Hypothesis 3 (that the current system creates incentives for behaviour that promote good government) indicated that some incentives discourage good government. Working in concert, the various public management sub-systems can produce perverse or negative behavioural incentives. The antithesis (that behavioural incentives exist that militate against achieving good government), was supported.

## Identification and description of system dynamics

The progressive tightening of contracts (specification and monitoring) in the New Zealand public management system has not addressed the perceived problem of departments sometimes failing to deliver Government objectives. Instead, the increasing emphasis upon contract specification and monitoring has in some cases led to unintended consequences as illustrated in fig 1.

**Figure 1 : Effect of Contract Theory - Initial attempt to describe**

Archetype used to assist thinking - Fixes that Fail  
(P.Senge "The Fifth Dimension, p.388)

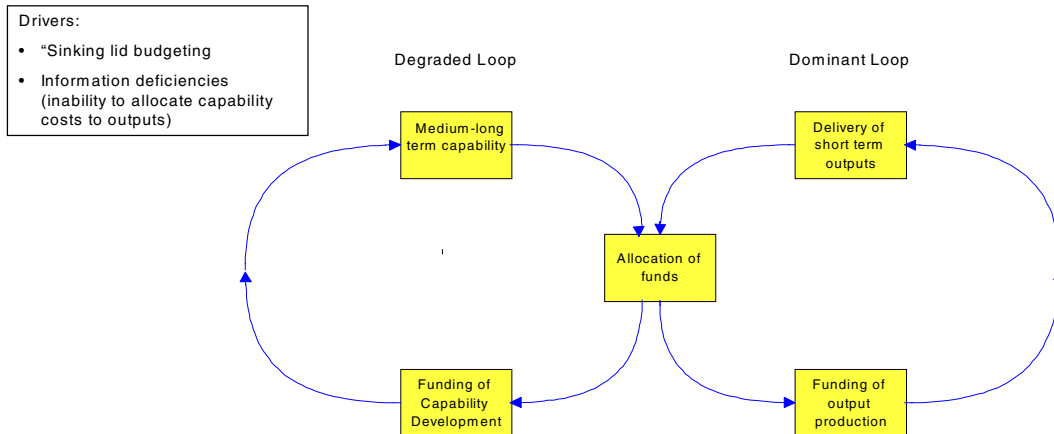


Source: Interviews and Team Discussion

The emphasis on achievement in the short-term results in allocation of funds to immediate output production at the expense of the development of organisational capability in areas that are less visible, but more important in the medium to long-term is illustrated in figure 2.

**Figure 2: effect of market approach - Initial attempt to describe system**

Archetype used to assist thinking - Success to the successful  
(P.Senge "The Fifth Dimension, p.385)

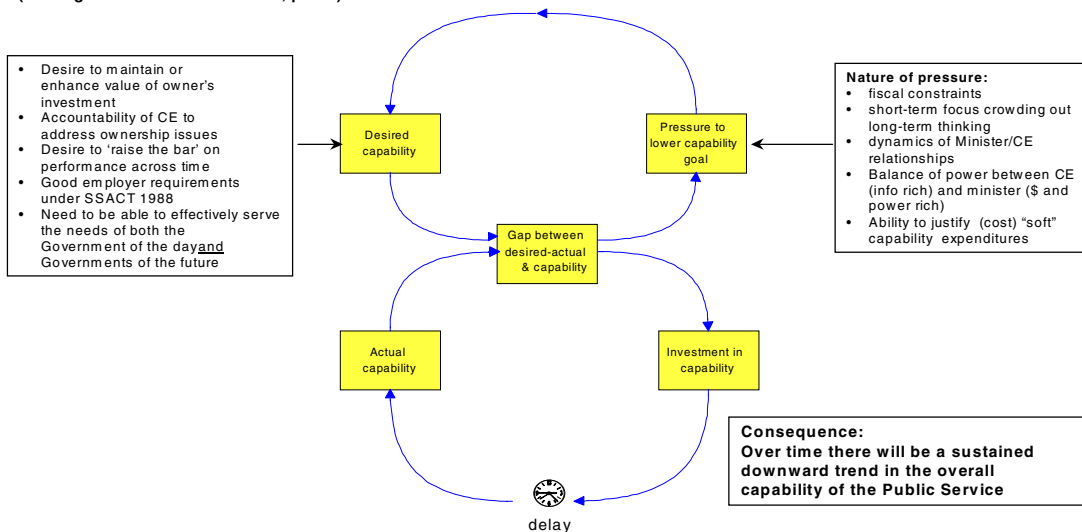


Source: Interviews and Team Discussion

Chief executives face an imperative to invest in the current and future capability of their departments, but this investment is not always "purchased" by ministers. An emphasis on measurable outputs, and pressures to reduce costs, hinders efforts to make a compelling case for investment, or can prevent capability development from being funded even if the case for investment can be made. A consequence is that, over time, there may be a sustained downward trend in the overall capability of the Public Service as shown in fig 3.

**Figure 3: Reducing expectations - Initial attempt to describe system**

Archetype used to assist thinking - Drifting goals  
(P.Senge "The Fifth Dimension, p.383)



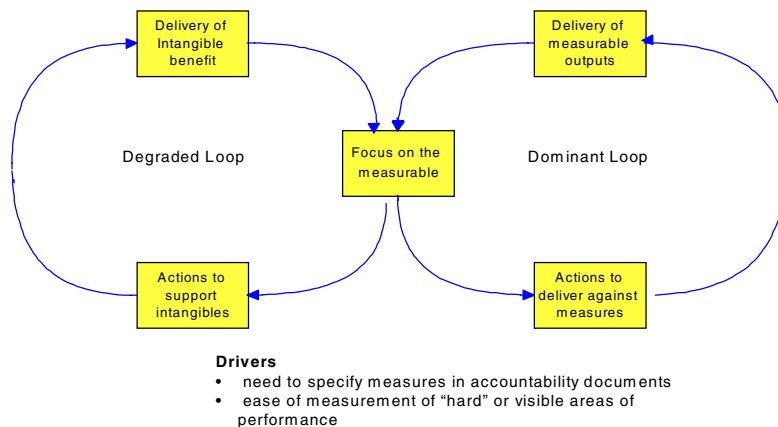
Source: Interviews and Team Discussion



The ‘what gets measured gets done’ (fig 4) archetype shows that the system’s emphasis upon contractual specification and monitoring of outputs and performance drives a focus upon those things that are measurable at the expense of those that are less amenable to measurement

**Figure 4: Managerialism (“What gets measured gets done”) - Initial attempt to describe system**

Archetype used to assist thinking - Success to the successful  
(P.Senge “The Fifth Dimension, p.385)

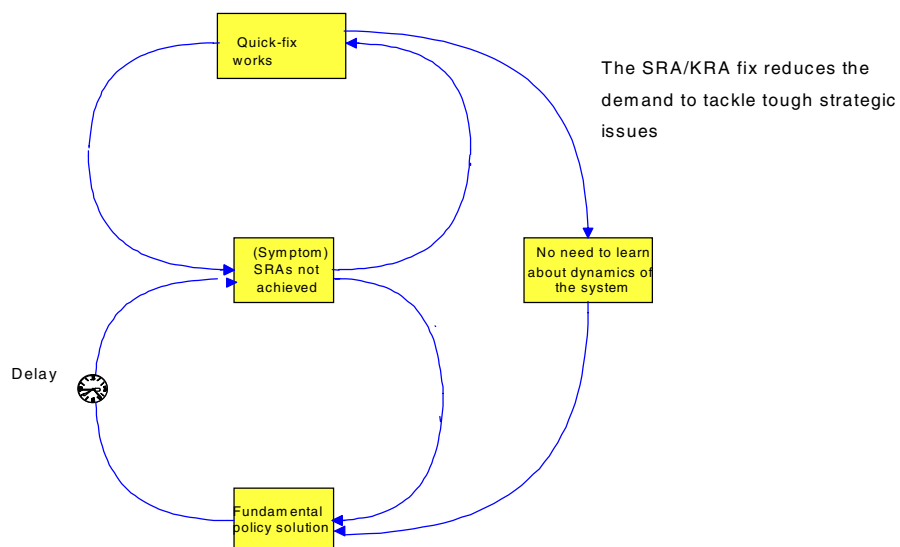


Source: Interviews and Team Discussion

A ‘quick-fix’ response to a symptom of system failure (e.g. the introduction of the strategic management system to drive strategic effort) diverts attention away from genuine understanding of what drives system performance, inhibiting long-term improvement in its performance (fig 5).

**Figure 5 :Strategic Priorities & KRA’s - Initial attempt to describe system**

Archetype used to assist thinking - Shifting the burden  
(P.Senge “The Fifth Dimension,



## Implications of findings

The project showed how the dynamics of the public management system can result in performance that is opposite to the prediction of the underlying theory.

This should not be seen as a failure on the part of the architects or operators of the system. Rather, it is the result of the operational dynamics of a complex soft system. The findings suggest that significant long-term improvement is unlikely to be derived from disjointed interventions into elements of the system, particularly if such interventions do not reflect an understanding of the relationships between system components.

It is significant that the project team tended to articulate the *manifest* (theoretical) system as the definitive description of the system. This is understandable because the task of optimising the performance of a system is (seemingly) made easier by having access to an accepted set of descriptions or stories about how it will behave, and why this is so. However, the project demonstrated that the *extant* system is clearly divergent from the intent of the *manifest* system. It is the extant (the real rather than written) system that must be the focus of attention if improvement efforts are not to be frustrated by a system that fails to respond as desired.

### Barriers to Future Development

The heart of the current system is a contractual approach to the relationship between the chief executive and the 'responsible minister'. Whilst this has been useful in requiring ministers to define more precisely what they expect the Public Service to deliver, it tends to constrain discussions about performance and organisational capability to a deterministic level. The scope for discretion is deliberately limited and, in a day-to-day sense, the intended outcome of "letting managers manage" is restricted to the parameters defined by the purchase agreement. Tight control over allocation of funding to 'output classes' does not foster dynamic transfer of funds between portfolios, even if the outcome of such a transfer would better meet the achievement of the Government's objectives. The overall result is tight control at the expense of innovation.

In the private sector, the managing director of a business is expected to maximise long-term shareholder value. By analogy, in the Public Service, a departmental chief executive could be expected to maximise the value to the community of the activities and capabilities of their department. The role of Government is to determine, through the political process, the range of outcomes that the public most values. Ideally then, a future system of control should be centred on how chief executives should relate to their responsible ministers (in both an individual and a collective sense) in a way that maximises the value of whole-of-government outcomes.

In the rapidly changing environment of today's society, this relationship needs to be dynamic. It needs to be controlled in a manner that enables both ministers and chief executives to respond in an optimising manner. This cannot be achieved through adherence to rigid contracts as management instruments, or indeed by depending upon contracts alone. The performance barriers inherent in the dominance of the system's

focus on outputs must be addressed, and discussions about performance must be raised to the level of the ownership interest of government.

### **The way forward**

The concept of ownership is not as well developed as the concept of purchase. This is in part due to its less tangible nature. It is at its essence, a simple notion involving responsibility for good governance, including effective strategic management of what is essentially the public's investment in the Public Service. The difficulty lies in translation from concept to practical understanding and tools that managers and ministers can use. Work on this task has continued over the last 12 months, and is ongoing.

The 1980s reforms assumed, given the separation of outputs from outcomes due to factors such as time, distance, and the effect of exogenous variables, the key locus of control should be accountability for the production of outputs (an age old problem for government). Emphasis on measurement of output delivery is thus the dominant control mechanism in the system. Ways to specify and measure public sector performance in the domain of ownership, and to find ways to make sensible links between outputs and outcomes (especially across agency boundaries), stand out as important endeavours for the future.

To pave the way for progress, a dialogue within government is required that teases out and develops new concepts. Even starting this dialogue has proven to be difficult because the current system drives hard for an answer before the thinking has been done. The lure of the quick fix is one of the biggest hurdles to be overcome.

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