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## RIGHTSIZING GOVERNMENT: LESSONS FROM AMERICA'S PUBLIC-SECTOR INNOVATORS

by  
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### EXECUTIVE SUMMARY

State and local governments now face a series of unprecedented challenges: budget deficits, bloated workforces, decaying infrastructure, shrinking tax bases, citizen opposition to new taxes, and taxpayer-imposed tax and spending limitations.

A new breed of public-sector managers, inspired by the successful streamlining of American business are trying to meet these challenges—not by increasing taxes or government spending—but by fundamentally transforming government through a process called *rightsizing*.

Rightsizing means establishing clear priorities and asking questions that successful companies regularly ask, such as: If we were not doing this already, would we start? Is this activity central to our mission? If we were to design this organization from scratch, given what we now know about modern technology, what would it look like?

A roadmap to rightsizing government would include these six key strategies:

***Competition.*** “Opening up city hall to the competitive process must be the fundamental aspect of change,” says Indianapolis Mayor Stephen Goldsmith. Since taking office in January 1992, Goldsmith has shifted over 50 government services into the marketplace by making city departments compete with private firms to deliver public services. Savings: \$28 million annually.

***Activity-Based-Costing (ABC).*** Few governments know how much it costs to deliver most public services. Without such data, it is impossible to know if city costs are competitive with those in the marketplace or how scarce tax dollars could be best allocated to serve citizens.

By attaching explicit costs to individual activities, and measuring the costs versus the efficiency and effectiveness of service outputs, ABC systems can provide an important tool for controlling costs and increasing productivity in the public sector. ABC brings to light costs which previously were hidden allowing managers to determine where they need to get costs down. ABC systems also lead to more accurate cost comparisons between in-house and contracted services when governments bid out services.

***Entrepreneurial, Performance-Based Budgeting*** Government typically rewards managers for poor performance: if crime goes up, police departments receive more money; if student test scores go down, the schools are given more cash. Poor outcomes lead to more inputs, rather than an improved process.

A number of political leaders are changing these perverse incentives by overhauling the annual budget process. Milwaukee's new budget is “performance-based”: success is measured according to outcomes, not inputs. Managers submit five strategic objectives and are held accountable for achieving these outcomes. Rather than measuring the number of road crew workers, for example, the Road Maintenance Department is judged according to the smoothness of the streets.

For performance budgeting to work, mayors and governors must hold the line on spending by freezing or capping budget allocations to each department. Capping spending growth helps create a culture where managers see their purpose as maximizing their accomplishments with available resources rather than trying to grow their budgets.

***Focusing on Core Businesses.*** Across the country, governments operate all kinds of enterprises and programs far removed from the central missions of government. Does the city of Dallas really need its own classical radio station? Should New York City be operating off-track betting parlors? In order to provide high quality basic public services, governments should concentrate on doing fewer things better.

Some noncore services—such as zoos, museums, fairs, remote parks, and some recreational programs—can be turned over to nonprofit organizations. Other city assets—such as airports, water systems, utilities and parking garages—can be sold to the highest bidder. All over the world, such enterprises are being privatized, allowing governments to turn physical capital into financial capital.

***Reengineering.*** In the private sector, companies are saving millions of dollars and increasing productivity by radically rethinking and redesigning work processes. This practice, called reengineering, helped Union Carbide cut \$400 million out of its fixed costs in just three years.

If pursued aggressively, reengineering could lead to dramatic productivity gains in the public sector. For example, installing document-imaging technology—whether in the courthouse, police station or welfare office—can eliminate the need to store millions of paper files. Dallas expects to realize significant space savings and handle court document requests with 10 fewer employees a year through document imaging. Yearly savings: \$250,000.

***Reorganizing Work Structures.*** Government's organizational structures, management systems, and job classifications also need to be reinvented. Rightsizing governments are tearing down rigid hierarchies and replacing them with flatter, leaner, and more flexible structures. They are organizing employees into self-managing work teams focused on their customers rather, and empowering them to make many decisions independently of department directors.

These rightsizing strategies and others are being employed by America's leading public-sector innovators to fundamentally transform government. They represent the cutting edge of government innovation, and hopefully, the future of state and local government.

## INTRODUCTION

A series of unprecedented challenges—the fourth year of a recession-induced severe fiscal crisis; strong citizen opposition to tax increases; and growing unfunded federal mandates—are causing real pain for state and local governments.

By compelling governments to change, these challenges also provide opportunities. By forcing governments to streamline, the fiscal pressures can have a positive long-term impact on government finances, efficiency, and organization. The most stunning example has come from Philadelphia. Under the leadership of Mayor Edward Rendell, Philadelphia—once nearly bankrupt—has eliminated a \$208-million deficit without raising taxes. Says Joseph Torsella, Philadelphia's former Deputy Mayor for Policy and Planning:

*We are lucky we had such a terrible fiscal crisis in Philadelphia. It was an opportunity for the city. By making people understand that change was absolutely necessary and could no longer be avoided, in the long run, the crisis will be one of the best things that happened to Philadelphia.<sup>1</sup>*

Philadelphia is not the only government that has chosen to tighten its belt rather than increase taxes in the face of the fiscal crisis. Across the country, innovative governments are undertaking fundamental changes.<sup>2</sup>

- **Charlotte**, North Carolina now has fewer General Fund employees per capita than in 1970. Over 400 positions have been eliminated in the last three years, saving the city about \$8 million a year.
- Between 1988 and 1992, the city of **Corvallis**, Oregon reduced its budget 24 percent in real terms, allowing it to cut property taxes by 5.6 percent.
- In the first 21 months of his administration, **Massachusetts** Governor, William Weld decreased the number of state employees from 49,750 to 42,864, a 13.8 percent decrease.
- **Milwaukee** has cut property taxes each of the last five years and kept spending increases below the rate of inflation.
- In two years, **Indianapolis** has erased an \$18-million budget gap and at the same time launched a \$500-million capital improvement program. Instead of increasing taxes, Indianapolis has increased productivity: the number of budgeted city employees was cut from 5,140 in fiscal 1991 to 4,329 in fiscal 1994—with no service reductions.

How have these governments been able to do it? Though each has embraced change in its own way, they have all fundamentally altered their organization's structure, priorities, and service delivery. This reorientation of government is called “rightsizing.”

### What is Rightsizing?

Rightsizing is a mission-driven process of continuous improvement. It requires government officials—with community input—to formulate a strategic vision for city hall or the state, including a plan for the future.<sup>3</sup> In rightsizing, public leaders establish clear priorities and ask questions that successful companies regularly ask, such as:

- If we were to design services anew, what would they look like?
- If we were not doing this already, would we start today?
- If we were to recreate city hall or state government today, given what we now know and given modern technology, what would it look like?

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<sup>1</sup>Interview with Joseph Torsella, June 7, 1993.

<sup>2</sup>Although most of the examples from this study are from cities, the rightsizing strategies outlined are also applicable to state government.

<sup>3</sup>Gerald Seals, “What is Rightsizing?,” unpublished paper, Greenville County, South Carolina.

Rightsizing governments focus funding on core functions, deliver these services more efficiently, abolish unnecessary work, and reduce or eliminate nonpriority programs.

### Rightsizing Versus Downsizing

Rightsizing is sometimes thought of as a polite term for downsizing. This is incorrect. Downsizing, usually coming in response to a fiscal crisis, tends to consist mostly of across-the-board spending cuts and employee reductions.

Downsizing in the public sector often amounts to little more than a short-term budget-balancing fix. As with a starvation diet, cutbacks are usually undone as soon as tax revenues begin flowing back into government coffers. Moreover, across-the-board spending cuts provide little guidance about what services government should deliver in the first place or how they should be delivered.

Rightsizing may include downsizing. For instance, to ensure that all agencies—including those usually exempt from efficiency improvements like police and fire—trim some fat from their budget, some governments make downsizing the first step in the rightsizing process.<sup>4</sup> However, to ensure lasting change in government, downsizing needs to be followed up with an aggressive rightsizing, restructuring program.

<sup>4</sup> Penelope Lemov, "Tailoring Local Government to the 1990s," *Governing* July 1992, pp. 29–32.

A review of rightsizing programs around the country reveals dozens of rightsizing techniques.<sup>4</sup> Most of these techniques fall into six categories. These constitute a **Six-Plank Program for Rightsizing Government**:

- #1: Injecting Competition into Public Services
- #2: Activity-Based Costing of Government Activities
- #3: Entrepreneurial, Performance-Based Budgeting
- #4: Focusing on Core Businesses
- #5: Reengineering Government Processes
- #6: Restructuring the Organization of Government

Integrated into a comprehensive rightsizing program, these six strategies can provide public officials with a powerful set of tools to dramatically transform government by cutting costs, increasing efficiency, shrinking the workforce, and improving the quality of services.

## PLANK #1: Injecting Competition into Public Services

*Opening up city hall to the competitive process must be approached as the fundamental aspect of change in order for a city that is successful to stay successful.*

—Indianapolis Mayor Stephen Goldsmith<sup>5</sup>

<sup>4</sup> For a listing of 37 rightsizing strategies see, Frank Benest, "Rightsizing for Local Governments," Innovations Group, Tampa, FL, 1992.

<sup>5</sup> "Moving Municipal Services Into the Marketplace," speech to the Carnegie Council, New York City, November 20, 1992.

Introducing markets and competition into government wherever possible is the most important component of a rightsizing plan. Absent enduring competitive pressures, other elements of a rightsizing program are likely to fall prey to the powerful weight of bureaucratic inertia.

In the private sector, competition drives companies to cut costs and increase innovation in order to deliver the highest quality products at the lowest possible prices. The public sector—usually thought of as a monopoly service provider—is insulated from such competitive pressures. With no direct negative consequences for failing to achieve desired outcomes, the public sector lacks any strong incentives to institute the fundamental changes required to dramatically cut costs and increase efficiency. The result: a lack of innovation and continually rising public-sector costs.

By opening up public services to competition from private providers, public officials assure that taxpayers are getting the best value and best quality services for their money.

The evidence that competition in public services can spur lower delivery costs is overwhelming. A number of independent governmental and academic studies looking at the effect of competition on service delivery have found it to generate cost savings in the range of 20 percent to 50 percent.<sup>6</sup>

Table 1

**COST SAVINGS FROM COMPETITION**

City	Cost Savings
<u>Indianapolis</u>	
Printing	47%
Microfilm	61%
Chuck hole filling	25%
<u>Philadelphia</u>	
Water Dept: Billing	50%
Custodial: City Hall	33%
Street Maintenance	50%
<u>Chicago</u>	
Custodial Services	33%
Cable Casting	83%

Source: Reason Foundation

Savings of this magnitude are prompting public officials throughout the country to expose government to the light of competition through a variety of methods:

- Competition between in-house units and private providers;
- Competition limited to private providers; and
- Vouchers given to citizens to freely select producers in the marketplace.

**A. Direct Public/Private Competition**

For over a decade the **Phoenix** public works department, under the leadership of Department Director Ron Jensen, has required city units and private firms to compete to deliver a variety of public services. In 1978, garbage collection became the first service opened to competitive bidding. Initially, private trash haulers were able to win all of the contracts. It took the public works department several years before it became competitive with the private firms. During this time, a new accounting system was brought into track costs, new

trucks were purchased to reduce crew size, and a suggestion program offering up to \$2,000 for cost-saving ideas was implemented. By the early 1980s, municipal workers were regularly winning contracts—18 out of 51 contracts put out to bid. Competition has saved the city over \$25 million.<sup>7</sup>

Currently, the most comprehensive competition program of any large city in America exists in **Indianapolis**. Since taking office in January 1992, the administration of Mayor Stephen Goldsmith has identified over 150 competition opportunities, and over 50 government services have already been shifted into the marketplace.<sup>8</sup>

<sup>6</sup> John Hilke, "Cost Savings from Privatization: A Compilation of Study Findings," Reason Foundation, *How-to Guide* No. 6, March 1993.

<sup>7</sup> David Graham, "Phoenix is Beacon of Trash Collection," *The Flint Journal*, April 25, 1993.

Already, this competitive process is resulting in about \$38 million in annual cost savings to the city.<sup>9</sup> Savings have averaged 25 percent in the half-dozen cases when city units beat out private firms in the bidding process. Services opened up to competition include trash collection, printing, equipment maintenance, municipal golf courses, street repair, and wastewater treatment operation.

**Philadelphia.** Mayor Rendell is also aggressively pursuing a competitive process for delivering city services. Since October 1992, 13 services have been exposed to competition and another 16 services are in the pipeline. Competitive bidding is saving the city \$16.4 million annually. Dozens of other candidates have been identified, including the city's entire water operation and management information system. City officials expect the number of services put out to bid to climb past 100 by 1995.<sup>10</sup>

Cost savings from competitive bidding are averaging 40–50 percent.<sup>11</sup> Moreover, the threat of privatization is having a ripple effect across city government. To avert privatization, in-house units are discovering ways to save 20 to 30 percent from their previous costs. Says Mayor Rendell:

*The knowledge that your department can be bid out is an enormous motivating factor. Ironically, privatization is the most effective way we know to restore productivity and the taxpayer's faith in government.<sup>12</sup>*

**Support Services.** Internal support services that serve other government units, such as computer repair and copying, can also be exposed to market forces. Called “internal markets” in the private sector, this management technique requires every business unit within a corporation to operate as an independent firm, deciding whether to purchase input supplies from other departments of the corporation or from outside suppliers.<sup>13</sup>

The logic behind internal markets is that large private corporations have many of the same characteristics as bloated government bureaucracies. Says MIT professor emeritus Jay Forrester, “They have central planning, central ownership of capital, central allocation of resources, and lack of internal competition.”<sup>14</sup> Proponents of internal markets believe the only way to get employees—in the public or private sector—to act like entrepreneurs is to expose them to the same competitive forces that drive real entrepreneurs in the marketplace.

In the public sector, the city of **Milwaukee** has introduced internal markets into some city services to push support service units to lower costs and become more competitive. The city's Internal Service Improvement Project (ISIP) allows city departments to purchase six different internal services from private firms, instead of city departments, if they can obtain a lower price and/or better quality.

Rather than setting rules and guidelines for improving the quality of their services, the ISIP program essentially says to city units, “If you want to survive, you must become competitive.” The program, launched in 1992, has already produced results. Some departments are cutting costs and obtaining better quality services by contracting with outside vendors. This has spurred the internal units to make dramatic changes and operate efficiently. The building maintenance division, for instance, is doing customer surveys and beginning to come in with lower bids than private firms.

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<sup>8</sup> Interview with Charles “Skip” Stitt, director of Enterprise Development, City of Indianapolis, October 4, 1993.

<sup>9</sup> Interview with Charles “Skip” Stitt, director of Enterprise Development, City of Indianapolis, September 30, 1993.

<sup>10</sup> Interview with Linda Morrison, city of Philadelphia, September 30, 1993.

<sup>11</sup> *Ibid.*

<sup>12</sup> Nancy Hass, “Philadelphia Freedom,” *Financial World*, August 3, 1993, p. 36.

<sup>13</sup> Michael Rothschild, “Coming Soon: Internal Markets,” *Forbes ASAP*, June 7, 1993, p.19.

<sup>14</sup> *Ibid.*

## B. Making Competition Work

In the long run, to be competitive with private firms, government units will have to be relieved of many regulations and bureaucratic procedures that decrease their productivity. For instance, a road maintenance crew in Indianapolis—now exposed to competition—complained that it took a week to get supplies from the city's purchasing department, while private firms can be confident of receiving necessary supplies the next day. Unless government units are given more autonomy when governments institute competition, they are being forced to operate in both worlds—the entrepreneurial and the bureaucratic.

In addition, workers and managers may be unprepared for a competitive environment. Training in structuring bids, writing business plans, developing unit costs, and putting the bid package together can give them the tools needed to make the transition to competition.<sup>15</sup>

At the same time, competition must have real consequences if it is to induce lasting change. If a government unit competes and loses in the bidding process to a private firm, it should be disbanded and the employees shifted to other work.<sup>16</sup>

## C. Private-Sector Competition

Instituting a systematic competitiveness program doesn't mean it will always be appropriate or worthwhile to let government units bid on every service. There may be a number of reasons why a public manager may want to limit competition to private-sector bidders for certain services:

- the service may require specialized expertise;
- there is adequate, sustainable competition in the private sector;
- for new or expanded services, city officials may not want to finance the large start-up costs necessary for new equipment and training personnel; or
- city officials may want to reduce liabilities and the size of the city payroll.

In addition, a mayor or governor may simply want government to get out of delivering certain services so resources and management attention can be focused elsewhere. Almost two years after launching his competition program, for instance, Indianapolis Mayor Goldsmith thinks that rather than letting city units compete for every service, a better approach may be to take the 20 percent of services farthest from city hall's core activities and competitively contract them out to the private sector and then let city units compete for the remaining 80 percent of services.<sup>17</sup>

## D. Vouchers

The most effective and appropriate way to inject competition into some public services—especially “soft services” like housing, job training, and health and social services—may be to issue vouchers to recipients so they can choose their own

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<sup>15</sup>John O'Leary and William D. Eggers, “Privatization and Public Employees: Guidelines for Fair Treatment,” Reason Foundation Privatization Center *How-To Guide* No. 9, September 1993, p. 11.

<sup>16</sup>For an extensive review of strategies for implementing competition, see E.S. Savas, *Privatization: The Key to Better Government* (Chatham, N.J.: Chatham House Publishers, 1987), pp. 255–273.

<sup>17</sup> Answer to audience question in speech at Tahoe Summit on Privatization conference, Incline, Nevada, February 11, 1993.



service providers. In addition to providing greater freedom of choice, vouchers bring consumer pressure to bear, creating incentives for consumers to shop around for services and for service providers to supply high-quality, low-cost services.

Vouchers have been used primarily by local governments for services to low-income residents such as day care, paratransit services, recreation services, cultural activities, drug treatment programs, housing, and job training.<sup>18</sup> Food stamps also represent a voucher system.

## PLANK #2: Activity-Based Costing (ABC)

*Activity-Based Costing is the first step in deciding which businesses the city wants to or should provide to the citizen and defining core, versus ancillary activities.*<sup>19</sup>

—Bridget Anderson, KPMG Peat Marwick Management Consultant

Few governments know how much it costs to fill a pothole, do a building inspection, or to clean out the sewers. In fact, most governments don't know how much it costs to deliver most public services.<sup>20</sup> Without such data, it is impossible for public officials to answer important managerial questions such as:

- Is this a good use of tax dollars?
- Are government costs competitive with those in the marketplace?
- How could scarce tax dollars be best allocated to serve our citizens?<sup>21</sup>

A number of years ago, some private companies began addressing their own problems involving the lack of good cost data by introducing new accounting systems to capture the true, “fully loaded” costs—direct, indirect and overhead—of delivering a product or service. Usually called “activity-based costing” (ABC) or “full-cost accounting,” such systems define input, output, and cost per unit data. They account for every hour of work, each piece of equipment, as well as all capital, facility, and overhead costs of an organization.<sup>22</sup>

According to Bridget Anderson, there are four main components of ABC systems.<sup>23</sup>

- Activities.* Defining what tasks are performed by the organization.
- Drivers.* The technique used to allocate activity costs to outputs.
- Outputs.* The final results or outcomes.
- Consumption.* The degree to which each activity should be allocated to each output.

By attaching explicit costs to individual activities, and measuring the costs versus the efficiency and effectiveness of service outputs, ABC systems have proven important tools for controlling costs and increasing productivity in the private sector. ABC brings to light costs which previously were hidden allowing managers to determine where they need to get costs down. (see figure below for a step-by-step approach to implementing ABC)

<sup>18</sup> Savas, *Privatization*, p.79.

<sup>19</sup> Bridget Anderson, “Performance Accountability System: Identifying Services and Costs,” Government Services Newsletter, KPMG Peat Marwick, Vol. 10, No. 3, May 1993.

<sup>20</sup> The primary exception is those services that are fully supported by user fees.

<sup>21</sup> Anderson, *Performance Accountability System*.

<sup>22</sup> Memo from Indianapolis Mayor Steven Goldsmith to Department Directors, January, 1993.

<sup>23</sup> *Ibid.*

### **Five-Phase Approach to Activity-Based Costing**

**Phase I – Define project objectives and establish department activities and outputs.**

This first phase focuses on a familiarization with department operations, personnel, and means of quantifying data. The most effective means of identifying activities and outputs, which serve as the foundation for the ABC model, are determined.

**Phase II – Collect and analyze appropriate cost and allocation methods.** In this phase, relevant cost information is collected. Then, appropriate cost drivers for the activities defined in phase I are developed and the most effective means of measuring departmental outputs are determined.

**Phase III – Collect the remaining current direct and indirect cost information.** The most probable activity cost pools are personnel costs, direct materials, vehicles and equipment, fixed asset and facility costs, and administrative overhead.

**Phase IV – Develop an ABC model.** Using the information in the first three phases, an ABC model is developed that is used to drive the activity cost pools to each output.

**Phase V – Summarize cost information and expand the departments' capabilities to include continuing use of the ABC model.** In order for the ABC model to be utilized most effectively, a training session is held to assist department personnel in understanding how to use the ABC model on an ongoing basis.

Source: KPMG Peat Marwick, *Government Services Newsletter*, May 1993, p. 9.

With a few exceptions, activity-based costing has not been widely utilized in the public sector.<sup>24</sup> This is beginning to change as governments discover several important uses for ABC. These are:

#### **A. ABC identifies all the services city hall provides and details what each service costs.**

Detailed cost information is crucial to providing government managers with the necessary information to be able to optimally allocate their limited set of resources. Once the full costs of performing a certain function are known, a government executive may decide that the costs of performing a certain function are greater than its value to the taxpayers and that the government should discontinue that activity.

After going through ABC, and having its full costs loaded on to its budget, Indianapolis' Advanced Wastewater Treatment Plant determined it no longer needed to operate a video conferencing center.

#### **B. ABC leads to accurate public/private cost comparisons.**

Without instituting ABC, opening up city services to competition may result in flawed comparisons of public and private delivery costs. By excluding indirect costs such as fringe benefits, facility costs, management/oversight, and utility and pension costs, cost comparisons tend to unfairly favor government delivery. A study of 68 cities found that cities on

<sup>24</sup> Milwaukee is a notable exception. Since the early 1980s, the city has had in place a fairly sophisticated computerized costing system. Other cities that have utilized one form or another of full-cost accounting include Sunnyvale, Calif., Visalia, Calif., and Phoenix, Ariz.

average underestimated their true costs of service delivery by 30 percent.<sup>25</sup> By adding up the full costs of government delivery, ABC systems eliminate this problem and put public units and private firms on equal footing when competing to deliver services.

### **C.ABC can lead to cost savings.**

By exposing the full costs of performing each function of city hall, ABC can assist managers with discovering and eradicating inefficiencies in their departments.

ABC can also reduce costs by stimulating healthy competition between government units. For example, if it is costing one city street crew much more to fill potholes than the other city crews, there is no way this can be concealed. The exposure creates powerful incentives to reduce costs.

By going through ABC, Indianapolis discovered that the cost for snow plowing in one district (\$117 per mile) was almost three times greater than in another district (\$38 per mile).<sup>26</sup> ABC helped the managers and workers determine that the higher cost district had an inefficient mix of supervisors and workers and had no control over its materials.

#### **Case Study: Activity-Based Costing Works in Indianapolis**

Among big cities, Indianapolis has moved the furthest to institute activity-based costing across city departments. According to Mayor Goldsmith, by adopting activity-based costing, "all sorts of wonderful things occur. It is the door by which competition and privatization have been opened up."

The first service to undergo ABC was pothole repair in which a city department was competing for a contract. In order to bid on the service, the department had to determine how much it really cost to fill a pothole.

The Transportation Department crew and their union approached Mr. Goldsmith recognizing that overhead would drive up their costs. They complained, "there are 92 of us truck drivers and 32 supervisors above us. We can't compete if you are going to attribute their salaries into our costs of doing business." The crew asked the mayor to reduce the overhead burden. The Mayor acknowledged that the crew was right, and many of the 32 supervisors were laid off.

The crew also discovered they could fill potholes with four workers rather than eight and, one truck instead of two. The city crew eventually came in with a bid thousands of dollars under the closest private bidder, saving the city 25 percent from its previous costs.

Source: William D. Eggers, "City Lights: America's Boldest Mayors," *Policy Review*, Washington, D.C., Summer 1993.

### **D.ABC assists government managers in setting appropriate levels of user fees.**

The user fees governments charge citizens or other governments for various services often fail to correspond to the true cost of providing the service. The result: the general fund ends up subsidizing user fee-funded activities or vice versa. In Corvallis, Oregon, ABC exposed utility rates to be higher than operating costs, meaning utility users were subsidizing the city's general fund. The result: the city reduced its utility rates.<sup>27</sup>

<sup>25</sup> Savas, *Privatization*, p. 259.

<sup>26</sup> For more details, see upcoming Reason Foundation *How-to Guide*, "Developing Performance-Based Budgets for Government," by Mark Abramson, March 1994.

<sup>27</sup> Interview with former City Manager, Gerald Seals, Corvallis, Oreg., September 23, 1993.

### PLANK #3: Entrepreneurial, Performance-Based Budgeting

*The budgeting process must be used as a lever (to rightsize) government. It is the most important lever available to a mayor or city manager.*

—Anne Spray Brooker, Director of Administration, City of Milwaukee<sup>28</sup>

In the public sector, the budgeting process typically unintentionally rewards managers for decreasing productivity. If crime goes up, the police department gets more money. If test scores go down, the schools are given more cash. Poor outcomes lead to more inputs, rather than an improved process (this phenomenon is also sometimes present in the private sector).

Consider Westminster, California. The Police Department was proud when it came in \$400,000 under budget in 1992. But when the Fire Department ended up \$400,000 *over* budget, city officials reacted by taking funds away from the police department and giving it to the fire department. The Westminster Police Department learned that in government, efficient performance and high productivity often get penalized.<sup>29</sup>

One way governments are attempting to change these paradoxical incentives is by transforming their budgets. These new budgeting strategies go by names such as “expenditure control budgeting,” “performance budgeting,” “results-oriented budgeting,” and “mission-driven budgeting.” While differing in their details, the central objectives of each of these budgeting strategies are the same. These are:

- Central control of the growth of *total* spending;
- Decentralized control to department managers of the authority for *specific* spending; and
- Increased *accountability* for performance.<sup>30</sup>

Because the main emphasis is on getting department managers to act more entrepreneurially and measuring programs by their performance, as a shorthand, these budgeting strategies can be called “entrepreneurial, performance-based budgeting.”<sup>31</sup>

Entrepreneurial, performance-based budgeting shifts the focus of the budgeting process from internal concerns—such as line items and inputs—to external considerations—customers and outputs. By measuring efficiency and effectiveness and linking the money spent on services to actually achieving certain outcomes, this kind of budgeting is more accountable to the taxpayers. The concept of performance-based budgeting is not new—the idea goes back over 20 years. “What is new,” says Mark Abramson, a government budgeting expert who has assisted a number of cities in implementing performance budgeting, “is the emphasis on *managing* by results.”<sup>32</sup>

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<sup>28</sup> Interview with Ann Spray Brooker, City of Milwaukee, August 10, 1993.

<sup>29</sup> John O’Leary and William D. Eggers, “Chopping Big Government,” *Los Angeles Daily News*, September 12, 1993.

<sup>30</sup> Dan Cothran, “Entrepreneurial Budgeting: An Emerging Reform,” *Public Administration Review*, September/October 1993, Vol. 53, No.5, pp.445-454.

<sup>31</sup> For a more detailed guide to implementing performance-based budgeting see the upcoming Reason Foundation *How-to Guide*, “Developing Performance-Based Budgets for Government,” by Mark Abramson, March 1994.

<sup>32</sup> Interview with Mark Abramson, November 22, 1993.

#### Cities with Entrepreneurial Budgeting Systems

Indianapolis, IN Kingsburg, CA  
 Milwaukee, WI Westminster, CO  
 Sunnyvale, CA Chandler, AZ  
 Fairfield, CA Visalia, CA

Entrepreneurial, performance-based budgeting also requires changes in the way public employees are compensated. Automatic, across-the-board pay increases and seniority-based salaries are replaced by compensation based primarily on performance—the *value* each employee creates.

**Sunnyvale, Calif.**, is the pioneer of entrepreneurial budgeting for performance. Since 1972, the city's sophisticated budgeting system, called (PAMS), has rewarded managers according to how well they achieved desired outcomes, with their salaries raised or lowered based on measured performance.

With detailed information at their fingertips on the quantity, quality, and cost of each service they deliver, the Sunnyvale city council doesn't even bother voting on line items.<sup>33</sup> The council tells each department what results it wants and the department returns to the council with detailed figures on how much achieving this outcome will cost. The council then, in essence, “buys” the level and quantity of service desired.

Sunnyvale's successes with performance budgeting have been so dramatic that its budgeting system was highlighted in an August 1993 visit by President Clinton. Between 1985 and 1990 the average cost of delivering service dropped 20 percent; one year the city even rebated \$1 million in property taxes.<sup>34</sup> In a 1990 comparison with other cities of its size, Sunnyvale found that it accomplished most functions with 35 to 45 percent fewer employees and that Sunnyvale employees tended to be better paid. On a per-capita basis, Sunnyvale's taxes were lower than any city in the survey.<sup>35</sup>

Another problem with traditional budgets is that, loaded with terms such as “subfunds” and “noncapitalizable equipment” and containing an abundance of meaningless data on inputs, they don't really tell citizens how their tax dollars are being spent. To rectify this, in August 1993, **Indianapolis** introduced its own outcome-based, entrepreneurial budget.

The city's budget is now called the “popular budget” because, for the first time in decades, people can actually understand what it contains. The popular budget contains each department's goals, expenditures and desired outcomes, and the activities proposed to achieve these outcomes.<sup>36</sup> This information is designed to spur debate over both the city's goals and whether each department's proposed activities advance the city towards these goals. It also allows city councilmembers and citizens to make informed choices about tradeoffs. For example, should an extra \$100,000 be spent to get the streets cleaned twice a week or would the additional dollars be better spent on extra police foot patrols?<sup>37</sup>

<sup>33</sup> David Osborne and Ted Gaebler, *Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector* (Reading, Massachusetts: Wesley Addison Publishing Company, Inc., 1992), p. 145.

<sup>34</sup> Financing Local Government, Vol. 5, No. 19, March 31, 1993, p. 1.

<sup>35</sup> Osborne and Gaebler, *Reinventing Government*, p. 145.

<sup>36</sup> 1994 Popular Budget, City of Indianapolis, August 1993.

<sup>37</sup> Bridget Anderson, “A ‘Popular’ Budget Focuses on Management,” KPMG Peat Marwick's Government Management Casebook, in *City & State* magazine, September 13, 1993, p. 7.

### Case Study: Milwaukee Uses Budget to Transform Managerial Incentives

In the spring of 1993, **Milwaukee** became the first big city to adopt to an entrepreneurial, performance-based budget. Milwaukee's new budgeting system is based on the recognition that the annual budget should articulate the city's long-term, strategic goals.

The budgeting process begins with the mayor setting an overall expenditure limit (spending has been kept under the rate of inflation since Mayor John Norquist took office five years ago). Each department's allocation then reflects the mayor's priorities for the city. This central control of overall spending growth ends the annual budget game in which individual departments inflate their budget request and then contend they cannot possibly deliver basic services when their requests are cut by the budget office.

After receiving its fund allocation, each department is charged with developing a strategic plan that contains no more than five objectives. Managers are then given great freedom to put together a mix of activities to achieve these objectives.

With increased autonomy, however, also comes increased accountability. Through a system of annual performance measures, Milwaukee department managers are held accountable for achieving the outcomes. Unlike other performance measuring systems—which tend to evaluate managers on the basis of internal management indicators like accounting inputs and workloads—Milwaukee's system measures actual impact on the community. The Road Maintenance department is held accountable for the smoothness of the streets, rather than the number of crews on the street.

By giving managers greater freedom to achieve pre-stated objectives, and by holding them accountable for results, Mayor Norquist is trying to create a culture where managers see their purpose as maximizing their accomplishments with available resources rather than trying to grow their budgets. Explains Department of Administration Director Anne Spray Brooker:

*We're trying to use market forces to generate improvement rather than set up a whole system of rules and regulations. By holding department managers accountable for outcomes we are generating pressures from the departments themselves to do away with inefficient city practices.*

Source: William D. Eggers, *Policy Review*, Summer 1993.

Public officials experienced with entrepreneurial, performance-based budgeting suggest a number of basic lessons to ensure its success:

**1. Freeze or strictly control budget allocations.** In order to force managers to cut costs and increase efficiency, government executives must hold the line on budget appropriations. When denied budget increases, managers may argue that services will have to be cut. However, when the recourse to more funding is gone, managers usually display creativity and imagination and find ways to get the job done. Writes Matthew Ridenour, the former Director of Management Services at Indianapolis:

*When budgets are frozen, managers may be inclined to refocus on core services and make tough decisions on how to deliver them efficiently. This strategy is almost risk-free in a government environment since the less an organization is exposed to competition, the more capacity exists in the system to improve service while reducing cost.<sup>38</sup>*

<sup>38</sup>Matthew Ridenour "Performance Accountability System: Services and Costs—Setting the Stage," Government Services Newsletter, KPMG Peat Marwick, Vol. 10, No. 3, May 1993.

**2. Performance budgets should incorporate long-term strategic plans.** A long-term strategic plan is especially important for new administrations moving toward performance budgeting because many managers will be unsure of the chief executive's new goals. By giving managers cues into the chief executive's long-term desired outcomes, a strategic plan frees up managers to try innovative approaches to realize these goals. Without this vision, middle managers will be very reluctant to diverge far from past practices.

**3. The same people should be involved in writing the strategic plan and budget.** Unless the same teams draw up the strategic plan and annual budget, the necessary linkage between the two may fail to materialize.<sup>39</sup>

**4. Don't let managers duck accountability.** Department managers inevitably will claim they can't be held accountable for achieving certain results because all outcome determinants are not under their control. While there will usually be some truth to these claims, department managers should still not be allowed to skirt responsibility. They must be forced to take ownership of the outcomes. "When they tell me they can't be held accountable," says Milwaukee's Ann Spray Brooker, "I say, you can certainly influence an outcome. If not, why are we spending \$800 million a year."<sup>40</sup>

**Corvallis, Oregon Borrows a Budget Innovation from Honda Motors**

The city of **Corvallis, Oregon** boosted its productivity and cut costs by taking a lesson from Honda Motors and making city hall compete with itself. From 1988 to 1992, under the direction of former City Manager Gerald Seals, the city had an unwritten rule that the budget submitted each year to city council would be less than the previous year's budget and even this amount would be underspent over the course of the year. The result: between 1988 and 1992, the city's budget dropped by over \$20 million (inflation-adjusted).

## PLANK #4: Focusing on Core Businesses

*The only time government ever kills programs is by refusing to feed them. This is policymaking by neglect. City officials need to go back to first cases, look at everything city hall does, and ask whether government has to do this at all.*<sup>41</sup>

—Ronald Henry, Director, Pennsylvania Intergovernmental Cooperation Association (PICA)

The fourth plank of a comprehensive rightsizing program is evaluating what government should do and not do in the first place. One of the most important features of entrepreneurial budgeting is that it compels public managers to focus financial resources on their core businesses. This forces managers to ask questions such as:

- Is this activity advancing me towards one of my desired outcomes?
- Does this fit in with my strategic plan?
- If not, should we even be doing this at all?

Across the country, governments operate all kinds of enterprises and programs that may be far removed from the core missions of city hall or the state house. **Dallas** runs a classical radio station; **New York City** operates off-track betting parlors; **Denver** and numerous other cities manage botanical gardens; **Jacksonville**, Florida runs a canning plant; and dozens of cities own and operate zoos. Says Indianapolis Mayor Goldsmith, "It is great to privatize to create competition, but if government is not receiving any value from this at all, it ought to be just closed down and let the market operate on its own."

<sup>39</sup> Brooker interview, August 10, 1993.

<sup>40</sup> *Ibid.*

<sup>41</sup> Interview with Ronald Henry, June 7, 1993.

In order to adequately focus on government's core businesses, cities and states should consider getting out of ancillary activities that often serve mainly as distractions. One way to do this is through privatization. The three most common privatization techniques used by governments to divest the financing and delivery of a service or enterprise to the private sector are:

- Transfer to a nonprofit organization or neighborhood group;
- Transfer to the for-profit, competitive market through “commercialization”; and
- Sale or lease of assets.

#### **A. Transfer to Nonprofit Organization or Neighborhood Group**

Facing the prospect of imminent closure due to severe fiscal restraints, government officials are looking for alternatives to government management and funding of many non-core services and facilities. They are increasingly discovering that by turning some noncore services—such as zoos, museums, fairs, remote parks, and some recreational programs—over to nonprofit organizations, they are able to ensure that these institutions don't drain the budget. Consider a few recent examples:

- In July 1992, the city of **Pittsburgh** turned over the city Aviary to a group of concerned citizens.<sup>42</sup>
- In **Norfolk**, Virginia, on January 1, 1993, the nonprofit Norfolk Botanical Society took over the formerly city-owned botanical gardens. On the same day, the gardens received its first \$1 million private donation.<sup>43</sup>
- In 1992, **Milwaukee** turned over operation of the city's numerous farmers markets to the private sector.
- In July 1992, the Mint Museum in **Charlotte**, North Carolina was leased to the museum's private board of trustees.

When government-owned cultural institutions such as zoos and museums are transferred to private, nonprofit operators, the city or state usually continues to subsidize these entities. Charlotte's Mint Museum, for instance, will continue to receive \$1.1 million from the city annually. The difference is that the subsidy is usually lower than previously, and the annual amount is often frozen or decreasing in the future. This encourages the nonprofit operators to operate the cultural institutions more entrepreneurially in order to seek greater private support from patrons and donors, and to improve offerings to generate more user fees.

**Self-Help Approaches.** Local governments can also empower neighborhood residents, organizations, and churches to generate self-help programs to meet community needs. Community groups can be assisted in forming neighborhood crime watches, maintaining their neighborhoods, providing recreation programs for youths at local parks, and developing job training programs.

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<sup>42</sup> “Privatization Potpourri,” *Privatization Watch*, February 1993, p. 5.

<sup>43</sup> Donna Lee Braunstein, “Botanical Gardens Flourish Under Private Management,” *Privatization Watch*, March 1993, p. 3.



## B. Transfer to Competitive Market

Some public services can be transferred to the private for-profit sector without any continuing subsidies. Private firms recover their costs by charging fees on a subscription basis to resident users. This form of privatization is sometimes called “commercialization” or “service shedding.”

The public services most likely to provide the best opportunities for commercialization are solid-waste collection and disposal, meter maintenance and installation, vehicle towing and storage, recreation programs, and emergency medical services. Private delivery and financing of many of these services is already quite prevalent in the United States.

In a 1990 International City/County Management Association (ICMA) survey, for instance, 30 percent of government respondents reported that residents contract directly with private haulers for garbage collection in their municipalities.<sup>44</sup>

One factor that often induces cities to get out of the trash collecting business is the prospect of large capital investment in new equipment. In 1990, **Traverse City**, Michigan's garbage trucks needed to be replaced. Rather than spend over \$250,000 for two new trucks, the city decided to get out of the waste business.<sup>45</sup> The city sold its two waste-packer machines and its list of 2,200 residential trash customers to West Michigan Disposal for \$224,000. By purchasing the list from the city, West Michigan Disposal gained an edge in attracting customers; however, city residents were allowed to contract with any of the many area waste haulers for trash collection.

Emergency and nonemergency ambulance services are also often provided without taxpayer subsidy. Most communities have at least one private ambulance service providing services without taxpayer support. About two dozen cities, including **Las Vegas** and **Fort Wayne**, Indiana, have full-service, state-of-the-art emergency medical services systems that are 100 percent user-funded.<sup>46</sup>

### Prioritizing Services

One way of arriving at a consensus about which services to cut or eliminate and/or which services to increase funding for is to prioritize services. Citizens, city councilmembers, and city employees are surveyed and asked to rank all city services according to their importance to the community. The goal is to arrive at a rough consensus about the most critical and least critical services the city provides. The surveys should also ask about the most appropriate levels of service given current fiscal realities. **San Antonio**, and **Wilmington** and **Charlotte**, North Carolina, and numerous other cities have developed weighted rating systems that rank services according to their value to the community.

<sup>44</sup> William D. Eggers, ed., *Privatization 1993: Seventh Annual Report on Privatization*, Reason Foundation, April 1993.

<sup>45</sup> “Traverse City Puts Innovation in Waste Contracting,” *The Michigan Privatization Report*, The Mackinac Center for Public Policy, No. 93-3, Summer 1993, p. 1.

<sup>46</sup> Interview with Brenda Staffen, American Ambulance Association, October 5, 1993.

Case Study: Rancho Palos Verdes, Calif.

Table 2.

**SALABLE STATE AND MUNICIPAL ENTERPRISES**

Whenever proposals surface for government to discontinue a service, citizens often assume the service will no longer be provided, period. Not so says David Riemer, the Chief of Staff to Milwaukee Mayor John Norquist, "the private sector, possibly now suppressed by the city, will usually spring to life to fill the gap."

This is what happened in the Southern California city of Rancho Palos Verdes when a budget shortfall in 1993 caused it to eliminate its recreation programs.

Fears that Rancho Palos Verdes residents would be left without any recreation programs were unfounded. Before getting out of the recreation business, the city did a survey of the surrounding area and discovered that private for-profit and nonprofit organizations were already providing—at reasonable prices—most of the recreation services the city was running.

After hearing the city would be dropping the recreation programs, many of the class instructors came to the city and said, "We will continue the programs if you will rent us your facilities."

The end result: many of the city recreation classes are still being offered. The only difference is they are being run privately and without subsidy from the city. In fact, the city is now making a small net profit from the facility rental.

Source: *Privatization Watch*, Reason Foundation, September 1993.

Airports (Commercial)	87	29.0
Electric Utilities	2,010	167
Gas Utilities	800	2.0
Highways and Bridges	n/a	95.0
Ports	45	11.4
Water Systems	34,461	23.9
Waste-to-Energy Plants	77	4.0
<b>TOTAL ESTIMATED</b>		<b>\$226.8</b>

Source: Reason Foundation, "Mining the Government Balance Sheet,"

*Policy Insight*, No. 139, April 1992.

### C.Asset Sales: Mining the Public Balance Sheet

In the private sector, businesses periodically inventory their balance sheets and sell off unproductive divisions or assets. Under new leadership, these divisions often receive a new lease on life and become dynamic independent companies. This management practice is called "mining the balance sheet."

Governments worldwide have followed the private-sector lead and are "mining the public balance sheets" by selling or leasing state-owned assets to the private sector. Over the last decade, \$328 billion in state-owned enterprises have been sold or turned over to private owners—\$69 billion in 1992 alone.<sup>47</sup> These assets have included many enterprises typically owned by states, cities or independent city authorities such as airports, water and wastewater systems, ports, gas and electric utilities, parking structures, stadiums, convention centers, and waste-to-energy plants (see Table 2.)

The worldwide trend toward private ownership of formerly government enterprises is prompting governments throughout America to explore the possibility of selling or leasing assets to the private sector. For example:

- **Los Angeles** Mayor Richard Riordan has proposed leasing Los Angeles International airport to a private operator.
- **Philadelphia** is studying selling its water system.
- The state of **Michigan** plans to sell off the state liquor system and accident fund.
- The city of **Milwaukee** is getting out of the parking business by selling its parking structures.
- A **Charlotte** city task force has recommended the city examine the feasibility of selling the Coliseum and other city assets.
- Hundreds of city and county hospitals have been sold to nonprofit or for-profit organizations since the mid-1970s.

By selling or leasing state enterprises to private entities, governments can turn dormant physical capital into financial capital, which can be used for more pressing needs such as rebuilding decaying infrastructure, debt relief, or tax relief. Governments also benefit financially by putting the asset on the tax rolls. Moreover, a substantial body of evidence—

<sup>47</sup>Eggers, *Privatization 1993*.

including a major eight-volume World Bank study—suggests that privatizing government assets can result in increased investment and improved efficiency and productivity.<sup>48</sup>

## PLANK #5: Reengineering Work Processes

*Don't Automate, Obliterate.*

—*Michael Hammer, management consultant and author of "Reengineering the Corporation: A Manifesto for Business Revolution"*

In the private sector, companies are saving millions of dollars and increasing productivity, performance, and service by leaps and bounds by rethinking and redesigning the way jobs are performed.<sup>49</sup> One way they are doing this is by "reengineering": organizing work processes in radically different ways than they were done before.

When organizations reengineer, workloads are reduced by greatly cutting down on paper flow, procedures, and internal requirements.

Although it usually involves making better use of technology, reengineering is not the same as automation. "Automating existing processes with information technology is analogous to paving cowpaths. Automation simply provides more efficient ways of doing the wrong kinds of things," write reengineering experts Michael Hammer and James Champy.<sup>50</sup>

Reengineering is also not merely streamlining existing processes and procedures. Rather than first asking how current processes can be improved, reengineering practitioners start over from scratch and ask what is the desired end result from the *customer's* perspective.

Reengineering is currently the foremost private-sector management trend. Union Carbide has used it to cut \$400 million out of its fixed costs in just three years, while Blue Cross of Washington and Alaska employed reengineering to increase labor productivity by one-fifth in only 15 months.<sup>51</sup>

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<sup>48</sup>Ahmed Galal, et al., World Bank Conference on the Welfare Consequences of Selling Public Enterprises (Washington, D.C.: Country Economics Department, Public Sector Management and Private Sector Development Division), June 1992.

<sup>49</sup>Michael Hammer and James Champy, *Reengineering the Corporation: A Manifesto for Business Revolution* (New York: Harper Collins Publishers, 1993), p. 32.

<sup>50</sup>*Ibid.*, p. 48.

<sup>51</sup>Thomas A. Stewart, "Reengineering: The Hot New Managing Tool," *Fortune*, August 23, 1993, pp. 41–48.

Reengineering's promise of dramatic productivity gains is beginning to draw the attention of innovative public officials. Dozens of state and local government processes have been reengineered with impressive results over the last several years including: **Napa County**, California's welfare caseload system; **Oregon's** Department of General Services Request for Proposal process; and **Connecticut's** Department of Labor job training and unemployment compensation program.<sup>52</sup>

**Implementing Reengineering**

1. Prepare and Disseminate the Case for Reengineering
2. Assemble Reengineering Teams and Select Reengineering Czar
3. Choose Processes to Reengineer
4. Understand Current Processes
5. Redesign Processes

Source: Derived from information in *Reengineering the Corporation*. See Footnote.

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<sup>52</sup> John Martin, "Reengineering Government," *Governing* March 1993, pp. 26-30.

Reengineering often involves purchasing new technology. So, in order to realize substantial future cost savings, government will often need to invest some upfront money in new technology. To fund its reengineering initiatives, Philadelphia has created a Productivity Bank. The bank is a revolving loan fund backed by \$20 million in city seed money.

Departments submit reengineering proposals to the bank's board. If the proposal is approved, the department must enter into a signed loan agreement with the board to pay back the bank in cost savings at a 2-1 ratio over a five-year period. The board includes the city budget director who makes sure the savings are taken out of the department's future allocations. By October 1993, the bank had made \$12 million worth of loans for 11 projects. In return for the loans, the city expects to realize \$42 million in cost savings and revenue enhancements over the next five years.<sup>53</sup>

Philadelphia still has a long way to go in restructuring. The city still hasn't achieved the kind of dramatic results typically associated with private-sector reengineering efforts. Most work process changes have been incremental. Nevertheless, once fully implemented, the reengineering projects, together with nearly 200 management and productivity reforms, should save the city over \$119 million annually according to Philadelphia officials and result in improved and more responsive services to taxpayers.<sup>54</sup>

#### Reducing Inventory

A private-sector task force is helping the city of Indianapolis to identify opportunities for cost savings, service improvements, and new ways of organizing work processes. The Service, Efficiency, and Lower Taxes for Indianapolis Commission (SELTIC), composed of nine of the city's leading entrepreneurs and over 100 volunteers, has spent nearly two years combing through city operations.

One of SELTIC's early discoveries was that city hall was not managing its inventory very well. In the private sector, corporations must carefully manage their inventories because holding too many supplies involves high financing and storage costs. Government officials, on the other hand, rarely pay attention to their inventories. After touring the transportation department facilities, SELTIC commissioner Jean Wojtowicz was stunned by the supplies, used furniture, and equipment lying around. Says Wojtowicz, "The government mentality is: If we don't use it, we better hold onto it, we might need it next year. The problem with stockpiling all this stuff is that it takes up expensive real estate."

A SELTIC team put in place a system in which the city would begin holding periodic "garage sales" of furniture, equipment, and materials. Eventually the city plans on eliminating, through this process, over 40,000 square feet of current leased space, saving as much as half a million dollars in leasing costs.

Source: William D. Eggers, "Competitive Instinct: Indianapolis Mayor Stephen Goldsmith is serious about cutting back city hall," *Reason*, August/September 1993, p.24.

Other government reengineering efforts include:

- **Internal Mail Delivery.** In most cities, each department, and sometimes many sub-departments, have their own unit to handle mail. By consolidating these mailrooms into one operation, city hall can realize around an 80

<sup>53</sup> Interview with Mike Nadol, assistant deputy mayor, City of Philadelphia, October 4, 1993.

<sup>54</sup> "Management and Productivity Initiatives Progress Report," City of Philadelphia, June 30, 1993.

percent space savings.<sup>55</sup> Reengineering its internal mail delivery is saving **Indianapolis** about \$300,000 annually.<sup>56</sup>

·**Court document systems.** Installing document-imaging technology eliminates the need to store millions of paper files. The city of **Dallas** expects to realize significant space savings and handle court document requests with 10 fewer employees a year through document imaging, for a yearly savings of \$250,000.

·**Hand-held Computers.** In **Chicago's** Public Health department, field nurses previously had spent about half of each day filling out forms for different funding sources, tracking patients, and other paperwork tasks. In 1993, the department purchased hand-held computers for the nurses, similar to those used by Federal Express delivery people. By allowing the nurses to enter in codes on sight, the computers have permitted the nurses to spend much more of each day helping sick people rather than doing paperwork.<sup>57</sup>

### Outside Expertise.

Bringing in outside expertise is often critical for success in reengineering. Outsiders tend to be more objective, bring a new perspective to the process, and sometimes are more apt than insiders to insist on radical change.<sup>58</sup> Says Indianapolis SELTIC Commissioner Jean Wojtowicz, "I think if you are inside government you're too close to the forest. Sometimes you need someone from the outside to come in and take a fresh look. Private businesses sometimes need this also."<sup>59</sup>

All the expertise provided by outsiders is of little use unless their recommendations are implemented—and governments have a long history of ignoring private-sector reports on streamlining government. To ensure that reengineering recommendations are carried through and also to involve internal units in reengineering, it is important to create a reengineering team within government. To drive changes through the bureaucracy, Philadelphia, for example, has its Office of Management and Productivity Improvement; Indianapolis has an Office of Enterprise Development; and Seattle and Charlotte have innovations teams.

Because there will be a natural tendency to resist change, the team leader or reengineering "czar" should be someone with the mayor's or governor's trust who is capable of jolting the system into action. Only with energetic proponents within government and the strong backing of the chief executive is reengineering likely to result in dramatic improvements. Says David Pingree, who directed Philadelphia's Private Sector Task Force on Management and Productivity Improvement, "If we didn't have the very strong support of the mayor, we would have ended up generating lots of good government studies that ended up on shelves—unread and unused."<sup>60</sup>

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<sup>55</sup> Interview with Charles Gibbons, Chairman of the Board, Tascor Corporation, September 7, 1992.

<sup>56</sup> Interview with SELTIC Commissioner Roy Nicholson, April 9, 1993.

<sup>57</sup> Interview with Carolyn Grisko, Director, Mayor's Fellowship program, City of Chicago, September 28, 1993.

<sup>58</sup> Hammer, p. 110.

<sup>59</sup> Eggers, "Competitive Instinct," *Reason*.

<sup>60</sup> Interview with David Pingree, April 1, 1993.

## PLANK #6: Reorganizing Work Structures

*Excessive layering may be the biggest problem of the slow-moving, rigid bureaucracy...extra layers of management mainly create distracting work for others to justify their own existence.*

*—Tom Peters and Bob Waterman, *In Search of Excellence*<sup>61</sup>*

Reengineering government cannot succeed in a vacuum. The organizational structures, management systems, and job classifications that now characterize most governments also have to be overhauled.

The present systems are archaic: elaborate controls and inflexible bureaucracies; thousands of job classifications; rigid hiring and firing procedures; layers and layers of middle management; stifling bureaucratic rules and regulations; and myriad procedures that virtually ensure that no employee, no matter how incompetent, will ever be fired. Government is like this because politicians and many taxpayers want a zero risk environment in the public sector. Zero risk, however, is impossible to achieve and has proven too costly—resulting in a lack of public-sector innovation and bloated bureaucracies. It has simply become too expensive to run government organizations the way they have been run. Reorganizing work structures is a business necessity.

Indianapolis Mayor Stephen Goldsmith believes job classifications, descriptions, and hiring forms should be eliminated—governments should foster an environment of “chaos.” “All city government really ought to be is a series of 100 projects around different clusters. We finish a project and we move on to the next one,” declares Goldsmith.<sup>62</sup>

### A. Flattening the Organization.

Management guru Tom Peters contends that no organization should have more than five layers of management.<sup>63</sup> After all, Peters reasons, the Catholic Church is able to oversee one of the largest organizations in the world, with over 800 million members, with just five levels.

The city of **Charlotte** has taken Peters' advice to heart. Until recently, the city's organizational chart was like that in most other city halls. The city had four employees who spent their time doing nothing but writing job classifications. And somehow, eight layers of management were needed just to oversee the maintenance of city streets.<sup>64</sup>

This is changing. By making the organization flatter and more flexible, Wendell White, Charlotte's City Manager is trying to move city hall into the modern era. The city's 24 departments have been merged into nine key businesses organized around city hall's core activities, and at least one layer of management has been cut away in each department.<sup>65</sup>

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<sup>61</sup> Thomas Peters and Bob Waterman, Jr., *In Search of Excellence* (New York: WarnerBooks, 1982).

<sup>62</sup> Eggers, “Competitive Instinct,” *Reason*, p. 22.

<sup>63</sup> Tom Peters, *Thriving on Chaos: Handbook for the Management Revolution* (New York: Alfred A. Knopf, 1987).

<sup>64</sup> William D. Eggers, “Charlotte: The Good News,” *Carolina Journal*, Vol. 3, No. 1, August/September 1993, p. 21.

<sup>65</sup> Interview with Wendell White, City Manager, City of Charlotte, July 26, 1993.

Previously, there were at least five departments, for instance, charged with providing some form of neighborhood services such as neighborhood development and public housing. These departments have been combined into one key business, “neighborhood services.” This eliminated substantial duplication of overhead and overlapping responsibilities which often create intergovernmental turf battles. Charlotte’s department director positions have been eliminated, and replaced by Key Business Executives who are being freed from a lot of red tape and bureaucratic micromanaging.

Another city that eliminated cumbersome management layers is **San Antonio**. In 1990, new city manager Andrew Briseno cut the number of assistant city managers from five to one, saving about \$600,000 a year in salaries for the managers and secretaries.<sup>66</sup> He then organized city hall around five different teams. The parks, recreation, art, library, and health departments, for example, while still remaining autonomous, are now part of the community service team. Many decisions that previously had to be approved by the city manager—such as pay raises and promotions—are now made by the department directors themselves (in some cases requiring approval from the team leader).

Government executives often discover when they flatten hierarchies and trim the size of the workforce that most of the excess employment in government is in middle management not in the front-line workers.

Many middle managers exist only as umpires, enforcing countless rules and regulations that impede creativity. Reducing the number of middle managers—both in the public and private sector is important not only because they are often superfluous, but because they can also prove to be the biggest barriers to organizational change. Through delay, sabotage, or inaction, organizational reform can be impeded. Reducing the number of middle managers need not mean mass layoffs, however. Middle management can often be reduced through attrition, early retirement plans, or transfers to other work. As part of its rightsizing program, the city of Corvallis, Oregon returned many of its middle managers to the front lines as lead workers.<sup>67</sup>

After the number of managers are trimmed, those left need to be transformed from protectors of the status quo to risk-taking architects of change. To do so, they need to be given much greater freedom to flexibly manage their employees and departments. In most governments, this means work rules and, in some cases, city charters, will have to be reformed, meaning city executives will also have to get the public to “buy-in,” allowing managers greater freedom.

#### City of Charlotte: Results of Rightsizing

##### The Numbers:

- Innovations totaling over \$2.8 million.
- No department has more than 5 layers of management.
- Eliminated 272 positions.
- Public Safety now makes up 53% of all positions.
- Annualized savings exceed \$8 million.
- No layoffs.

Source: Pamela Syfert, Deputy City Manager, City of Charlotte

<sup>66</sup> Interview with George Noe, Director of Management Services, City of San Antonio, September 8, 1993.

<sup>67</sup> Benest, “Rightsizing for Local Governments,” p. 87.



## B. Work Rules.

Myriad job classifications and work rules in the public sector severely constrain the ability of managers to manage creatively and flexibly. Work rules, job classifications, and regulations sustain antiquated positions and inefficient work processes for years.

This needs to end. In the rapidly changing marketplace within which local governments now operate, public-sector jobs and employees need to be constantly evolving.

### Aims for Work Rule and Charter Reforms

- Simplify Procedures and Job Classifications
- Redesign Jobs
- Improve Time Management
- Ease Procurement Regulations
- Give Managers Greater Flexibility

Source: Reason Foundation

The first step to reforming productivity-killing work rules is to survey middle managers about their constraints. Some of the questions Philadelphia Mayor Rendell asked all managers upon taking office included:

- What are the constraints that make your job harder to perform?
- What part of the union contract now impedes your operations?
- What isn't working in your department, and what changes are needed to make it work better?<sup>68</sup>

The survey resulted in a report containing hundreds of examples of work rules—many outlandish, some simply unnecessary. A major public campaign highlighting these examples helped the mayor garner popular support for work rule changes. As importantly, however, the manager survey helped to garner cooperation in reform from many middle managers. No mayor had ever systematically asked the managers these kinds of questions before. By asking them what obstacles prevented them from efficient performance and following through on eliminating many of the problems, Rendell was able to get many managers to buy-in to his rightsizing program and inspire them to be agents of change.

### Philadelphia Before Reform: Work Rules Handcuff Managers

Up until Mayor Rendell won some concessions in the fall of 1992, Philadelphia had some of the most costly, unproductive work rules of any city in the country. Firing employees was almost impossible; there were over 3000 job classifications; and employees could not be compelled to work overtime or perform any work under their job classification. Other examples included:

- Three city employees were required to change a light bulb at the airport: a mechanic to take off the light cover; an electrician to change the bulb; and a janitor to sweep up the dust.
- Requirements in the department of Public Works required sludge to first be shoveled from the water pipes to trucks, then unloaded onto the ground, and then scooped into another dumptruck. The effect was that it took 10 people just to move sludge from a water pipe to a sanitation truck.
- Employees at the Department of Human Services declined to use computers in their jobs because using a computer was not in their job classification.

Source: Eggers, *Policy Review*, Summer 1993.

<sup>68</sup> Interview with Joseph Torsella, former deputy mayor of Policy & Planning, City of Philadelphia, June 7, 1993.

### C. Independent Businesses.

Another way to empower managers and workers is by turning departments into independent businesses. For city managers to run government's core functions more in the manner of innovative, cost-cutting private managers, and less like bureaucrats, they need to be given more freedom.

For instance, they could be given responsibility for the following: all personnel decisions including salary and bonuses; acquiring all goods and services approved in the budget; and choosing between outside vendors and internal government units for support services such as fleet maintenance and computer services. Some of these reforms may require changes in state law or in a city's charter.

This is not to suggest that there should be no controls on public managers. With taxpayer money involved, the public sector has to be more vigilant than private companies in guarding against graft and other improprieties. However, a better balance needs to be struck between control and flexibility.

### D. Empowering Line Workers.

Empowering line workers is also essential to the rightsizing process. The ratio of managers to staff should be significantly reduced. Rightsizing governments let self-managed work teams make decisions previously made somewhere up the bureaucratic hierarchy.

Organizing work by self-managed teams can increase employee morale and raise productivity. "By putting people in teams, even in government, you are able to empower workers and drum out the laggards who are bringing everyone else down," says Charles Gibbons, the former CEO of Tascor, one of the country's leading companies specializing in outsourced services.<sup>69</sup>

Charlotte has gotten employees involved in finding savings and driving the process of change by creating innovations teams which solicit cost savings ideas from employees. In some departments, these teams are authorized to implement the cost-cutting ideas without the department director's approval. Working with the employees, the innovations teams have come up with \$2.8 million in savings.

## SUCCESSFULLY MANAGING THE TRANSITION TO RIGHTSIZING

*In implementing the rightsizing process, local government officials can easily destroy organizational morale and productivity. To maintain organizational effectiveness, those in charge of the rightsizing process must exert firm, yet humane and creative leadership.<sup>70</sup>*

*—Frank Benest, City Manager, Brea, Calif.*

Government executives must be careful not to demoralize the organization's employees as they precede through rightsizing.

Even when rightsized, public employees will be state government's or city hall's most important asset. Low workforce morale negatively affects public service delivery and could negate many of the gains from rightsizing.

<sup>69</sup> Interview with Charles Gibbons, Chairman of the Board, Tascor, September 7, 1992.

<sup>70</sup> Benest, "Rightsizing for Local Governments."

### A. Visionary Leadership: The Key to Managing Change.

Effectively communicating both the need for change and the nature of change is important for successful rightsizing. This must start with the person at the top of the organization.

The chief executive has to create a sense of urgency. This means being able to clearly explain to employees and taxpayers the changes in the marketplace that are driving the need for change. Each employee—or at the very least, all managers—must have an understanding and appreciation for what is to be accomplished and why. The fundamental changes that rightsizing involves will be resisted by many public managers and workers. The chief executive must get “buy-in” from public employees and taxpayers by infusing citizens and employees with hope about the city or state's future and by articulating a strategic vision for the organization. This message should be repeated frequently in five-minute stump speeches, brown bag luncheons, or informal roundtable discussions.

#### Techniques for Obtaining Employee Buy-In

1. Have top city officials hold regular brown bag lunches with managers and line employees.
2. Begin a rightsizing newsletter and hotline communicating upcoming changes and airing employee concerns.
3. Provide rewards for excellence and celebrate successes.
4. Create a talent bank for temporarily displaced employees.
5. Train employees in new skills and cross-train them to perform various functions.

Source: City of Charlotte, City of Indianapolis, and Reason Foundation

Without this kind of determined, visionary leadership, fundamental rightsizing is unlikely to succeed. Opponents of change within government will, silently but surely, kill parts of the rightsizing agenda through inaction, delay, and obstruction. It is also important for the chief executive to demonstrate strong support for the department directors and task forces that are trying to bring about change.

Moreover, if layoffs are necessary, government executives should get these over with right away. Delaying layoffs is inadvisable because of the uncertainty it creates among employees. It is preferable to do lay-offs upfront and then, if possible, promise that all future workforce reductions will occur through attrition.

Governments can use numerous strategies to ease the rightsizing process for employees and help to keep lines of communication open. Charlotte—which has an extensive rightsizing program (see Figure 1)—employs numerous strategies to ease the transition to rightsizing. The city has adopted a no-layoff policy so employees will not be reluctant to bring cost-savings ideas into the open for fear that increased efficiency will result in job loss. Moreover, those people transferred to a lower job classification due to rightsizing are not subject to pay reductions for the first year, and all employees receive training in self-managing work teams and handling change.<sup>71</sup>

### B. Reward Successes.

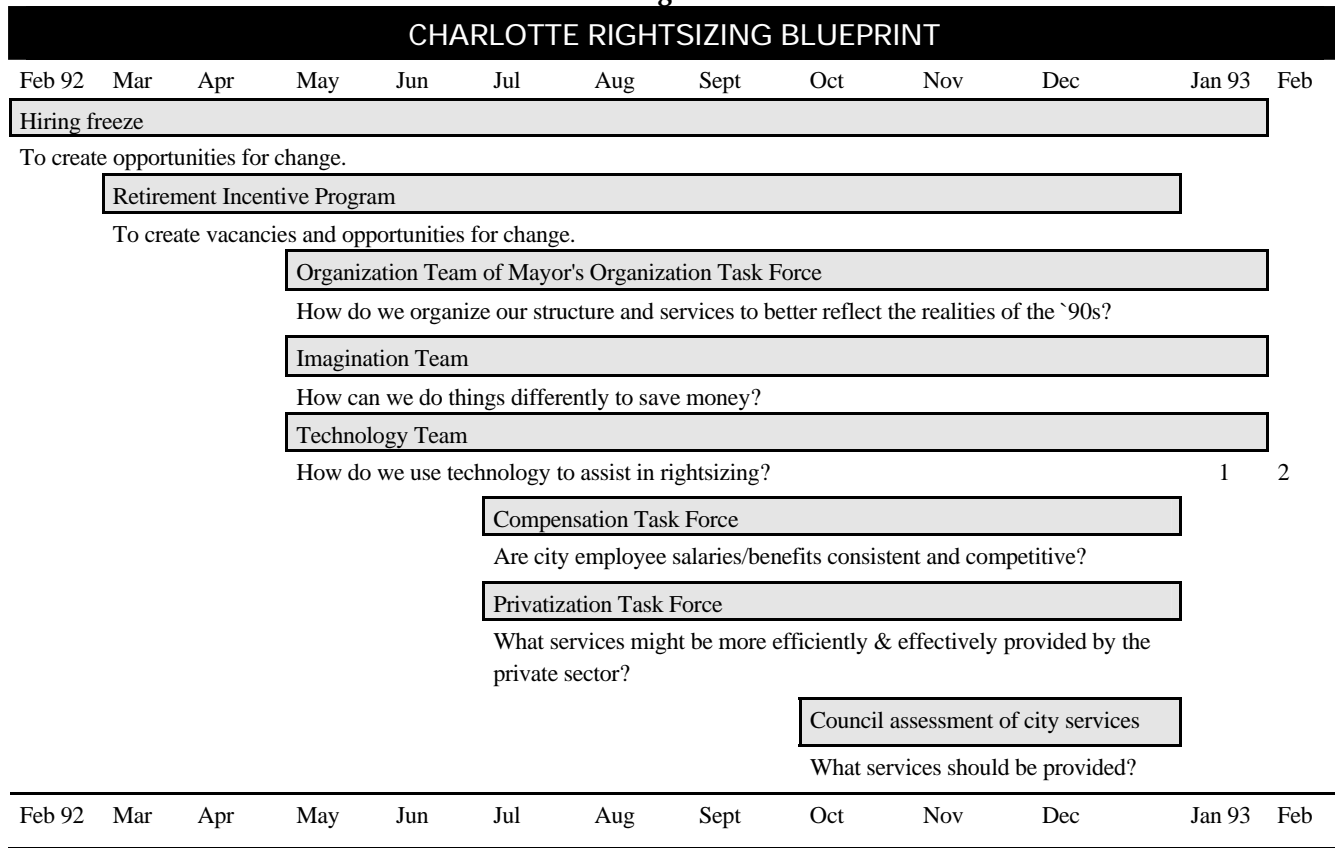
To maintain and increase morale in government and to get public employees to act as facilitators of change, government executives must reward and celebrate employee successes.

Each month, Mayor Goldsmith presents the “Golden Garbage” award to the Indianapolis city employee who finds the most egregious examples of government waste. The winning employee gets a toy plastic truck glued to a piece of wood and lots of press coverage for drawing attention to the waste. The first award went to an employee who found a garbage truck that broke down so often and was so expensive to repair that it cost the city \$39 for every mile it operated.<sup>72</sup>

<sup>71</sup> “Rightsizing Update,” presented to the Charlotte City Council, City of Charlotte, March 1, 1993.

<sup>72</sup> Eggers, “Competitive Instinct,” *Reason*.

Figure 1



Notes: 1 Development of Rightsizing Action Plan  
 2 Presentation of Action Plan to City Council

Governments may also want to consider sharing part of the savings generated by employee cost saving ideas with the employees. In Charlotte, the Department of Transportation gives gift certificates to employees who present cost-savings ideas to the department's Innovations Team. Phoenix also pays employees for cost savings ideas.

Lastly, managers can be encouraged to streamline department operations by allowing them to retain part of any unused budgeted funds and utilize them for capital projects or other long-term improvement projects.

## CONCLUSION

Faced with intense global competition and rapidly changing technology, American businesses have radically transformed the way they do business over the past dozen years.

Corporate hierarchies, layers of middle management, and bureaucratic rules and regulations have given way to self-managed work teams and environments of "chaos" that stimulate innovation. Unproductive divisions have been sold off, decision-making decentralized, overhead slashed, and non-core services farmed out to other companies. Over a decade after this war on bureaucracy began, American businesses are now prepared for the challenges of the 21st century.

Facing continuing fiscal stress and the negative economic and political consequences of more tax increases, state and local governments must declare their own “war on bureaucracy.” For most governments, instituting a comprehensive rightsizing program will mean a host of dramatic changes from past practices.

For most public-sector employees, rightsizing—whether viewed as painful or revitalizing—will require a complete change in psychology. For the first time, they will be asked to refocus nearly all their attention and energy on government’s customers: the taxpayer. “It is their responsibility to focus their complete energy on shifting resources towards activities that produce meaningful outcomes for citizens,” contends Matthew Ridenour, formerly of the city of Indianapolis. “If they cannot link a dollar of cost to more than a dollar’s worth of outcome, they must not spend the dollar.”<sup>73</sup>

As the 21st Century draws nearer, city and state governments throughout America would be wise to closely examine the rightsizing strategies now being employed by some of America’s leading public innovators.

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<sup>73</sup> Ridenour, *Performance Accountability*.

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