

DISCUSSION PAPER

SCHUMPETER COMES TO WHITEHALL

Cuts and innovation in public services

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FOREWORD

Reducing spending on public services is the Government's most pressing and difficult challenge. As social and economic issues result in rising demand for services, how we respond to these decisions will define how public services operate in the future.

However, we have come across many great examples of radical innovation in public services that are delivering better results for less money. The question now is how to make these examples the norm, rather than the exception.

'Schumpeter Comes to Whitehall' draws on the economist Joseph Schumpeter's analysis of innovation – and on NESTA's own experience of supporting innovation in public services – to consider how Government should approach the cuts in ways that prompt innovation.

As ever, we welcome your comments and views.

Jonathan Kestenbaum
Chief Executive, NESTA

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EXECUTIVE SUMMARY

“Times of innovation... are times of effort and sacrifice, of work for the future, with more anxiety than rejoicing.”

Joseph Schumpeter, 1939

The UK’s public services face a long and difficult period of austerity. To address the perilous state of our public finances, the UK Government has begun the task of significantly reducing public spending. This will have serious implications both for those who work in public services and the citizens that depend on them.

The crisis of government finances offers a chance to change our public services for the better. There are unique barriers to innovation in public services that are difficult to overcome in times of abundance. And it is radical innovation, innovation that puts citizens and users in control and redesigns services around them, that we need if our services are to be effective and sustainable in the long run.

This chance will pass us by if we do not put in place the right policies to encourage innovation now: the right systems to repurpose resources from ‘outmoded’ approaches to radically better approaches; a culture change in commissioning that puts community and civil society front and centre; and a dramatic shift from a culture of audit to a more trust-based culture of assurance.

The problem

The crisis in public finances is deep and urgent. To address the deficit, the UK Government has announced in the Emergency Budget in June 2010 that it will make £61 billion of savings by 2014-15. Making these savings will represent the tightest budgets in 30 years and the first five consecutive years of real cuts since 1948-49.

But the crisis facing public services is not only a financial one. Even before the recession, our services were struggling to respond to changing needs and expectations that were leading to increasingly high demand (and higher costs). Traditional models of service delivery – the state delivering to essentially passive citizens – were already unsustainable.

The future

There is broad agreement between political parties, public service workers and citizens that public services need to be transformed in order to meet new demands. Future services need to prevent rather than respond to problems, to involve the public and communities in a meaningful way, and be designed and managed much more locally.

There are hundreds of examples from around the world of radical approaches based on these principles that deliver better results for less money – including innovations developed by local authorities in the UK – and yet these approaches often remain outside of mainstream public services. This report contains a number of these examples, from Local Area Coordinators in Western Australia, which radically rebalanced the high proportion of spending on residential care services, to the Justice Reinvestment programme in Texas and Connecticut, which drastically reduced incarceration rates. These approaches are not just more effective: they are also dramatically cheaper, often saving between 20 and 60 per cent of costs.

What inhibits innovation in public services

The reason that this kind of innovation has not occurred in the

public sector is twofold. On the one hand, innovation is often difficult for a range of familiar reasons – a lack of funding and commissioning for new approaches, a culture of risk-aversion, a lack of incentives, and the legitimate need to be prudent with public money.

But on the other hand, a less observed problem is the effect on innovation of well-funded business-as-usual. Long-established services have a tendency to crowd out new approaches and are typically hard to decommission – especially when in many areas increased investment has been available, as it has been for the last decade. Steadily rising funding levels also allow, or have as a side-effect, an increase in audit and central control, neither of which is conducive to innovation.

Cuts and transformation in public services

The Austrian economist Joseph Schumpeter stated that innovation is the primary cause of economic progress and development. Innovation can be led by entrepreneurs breaking new markets, or by larger established businesses making radical changes to their own products, services and processes. This innovation transforms markets. It represents a process of ‘creative destruction’ in which old ways of doing things are repeatedly destroyed and replaced by new, better ways. This forces existing businesses and industries to adapt to new conditions by innovating to keep up or resisting change and risking being made obsolete.

For many valid reasons, public services have typically not been subject to the same kind of creative destruction seen in private markets. Considerable social harm would result from the breakdown of the public services that we depend on and pay for – far from the ambitions of any political party. Wholesale service closures would push demand elsewhere, undermining the actual efficiency and legitimacy of any cuts.

But this also means that radical innovation, and so transformation, are less prevalent in public services than in private sector markets. The challenge now for policymakers and those in charge of public services is to confront the disruption caused by cuts and use it to prompt innovation in public

services to make them better and more effective.

The alternative, in which some services are 'protected' while others are subjected to repeated incremental cuts rather than radical reform, would be a much less effective solution. It would hollow out the services that are cut, lock in low productivity in protected areas, and further marginalise the new approaches that are so crucial in dealing more effectively with future demand.

What this means for policy

Government should use the crisis to harness the potential for radical innovation in public services and put in place the right incentives to ensure the best chance for 'positive disruption'. This means three types of response:

- a) Systems to move resources from 'outmoded' approaches to radically better approaches.** Reconfiguration and decommissioning is vital to allowing new services to thrive – but the ten-year struggle to reconfigure London's hospitals is an example of just how difficult this is. Helping this happen requires putting in place effective 'failure regimes' to shift money away from unsustainable services, and supporting mechanisms like Social Impact Bonds that allow money to be invested in more efficient ways across departmental boundaries. Arbitrarily protecting frontline services could marginalise new approaches and so block radical reform. Instead, government should commit to protect (or improve) outcomes – that is, the actual impact that services have on the ground, however these outcomes are delivered.
- b) Reforming commissioning to encourage new community and local provision.** Civil society offers a powerful source of innovative ways to tackle social challenges, and a source of new providers and resources, but the public sector typically takes limited advantage of it. NHS Primary Care Trusts (PCTs), local authorities and other commissioners should tap into this by changing the way they commission, adopting phased approaches with wide eligibility criteria to attract new providers (especially social enterprise, community and patient organisations), and involving the public more closely in the design of alternative services.

c) Replacing the culture of audit with a light-touch process of assurance. Audit, monitoring and safeguarding have grown to the point where a typical urban local authority has numerous ‘watchers’ – public sector employees paid solely to monitor its performance. This central control militates against innovation and is costly in its own right. Policymakers should take on board the lessons of the Foundation Trust and Academy systems and immediately scale down the performance management of local authorities by audit bodies, PCTs and other bodies to strip away recognised barriers to the development of new approaches and free up resources to refocus public services on delivery.

Finally, policymakers need to be explicit about this strategy. The UK Government has been explicit about the reason for cuts, but an equally important question is *how* these cuts are made, with a view to where we want to end up.

In the private sector, such periods of ‘market restructuring’ inevitably mean job losses and business failures, and require workers to develop new skills as economies shift. The equivalent will also be true for public services. The question is whether the cuts made by government will protect the most vulnerable, and whether they will enhance the ability of public services to innovate and so respond to the challenges of the future. Government should do all it can to ensure that radical reform can emerge from this challenging context.

A note on terminology

‘Government’ as used here can refer to the UK Government and to the Devolved Administrations in Scotland, Wales and Northern Ireland, with appropriate caveats as to the varying powers and responsibilities of these administrations over specific budgets and services.

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PART 1: THE NATURE OF THE CRISIS IN PUBLIC SERVICES

Schumpeter's view of innovation

In his most famous work, *Capitalism, Socialism and Democracy*, the Austrian economist Joseph Schumpeter (1883-1950) referred to radical restructuring in private sector markets as periods of 'creative destruction', the process through which old ways of doing things are repeatedly destroyed and replaced by new, better ways.¹ These revolutions periodically reshape the existing structures of industries, and so the economy "*not only never is but never can be stationary*". By focusing on innovation and taking a dynamic view of markets as opposed to what he regarded as the static and rather abstract view of previous economists, Schumpeter saw creative destruction as a process by which new business models, products and services replace outdated approaches.

In Schumpeter's analysis, transformation can happen as new technologies or changes to market conditions challenge existing approaches and force businesses to innovate and take advantage of new methods. These periods of market restructuring can both be led by entrepreneurs and allow them to break into new markets, toppling incumbent business models and paving the way for future growth.

A contemporary example is the way that the internet

and new media are threatening to overturn 'old media' sectors such as newspapers and broadcasting. Schumpeter's analysis also accounts for why many of today's leading companies have been formed during economic downturns when new business models might be more advantageous, such as 3M, General Electric, Intel and Microsoft.²

Schumpeter's early work emphasised the role of entrepreneurs in provoking and exploiting transformation, while his later work focused on larger businesses with their much greater resources to invest in innovation. Though this sort of change can be difficult and disruptive, causing some businesses to fail and demanding new skills, trying to inhibit it risks undermining future growth in the economy.

The UK's public services face an immediate crisis that will require cuts, not just efficiencies

The UK's public services face significant challenges. The most immediate is the level of the UK's deficit, now predicted by HM Treasury to peak at 70 per cent of GDP in 2013-14.

'Efficiency savings' in government departments and public services will only deliver a fraction of the savings necessary to reduce the deficit. Cuts to public services are an unfortunate but inevitable prospect.

Traditionally, efficiency drives have focused on narrow measures, rather than looking radically at what service is delivered and how. The dividing line between front and 'back office' functions is far less clear cut than is often presumed, and the effects of streamlining or stripping back aspects of a service may have unintended consequences elsewhere. Isolated efficiencies can often increase 'failure demand' – preventable demand resulting from failures elsewhere in service or system – and so put further pressure on services elsewhere (systems analyst John Seddon suggests that on average around 40 per cent of demand on

public services is a result of 'failure demand').³

In the March 2010 Budget under the previous Government, HM Treasury identified £19.4 billion of savings from actions such as streamlining administration, switching to cheaper suppliers and using assets more intelligently.⁴ However, efficiencies that have been promised in the past have not always materialised. There is little concrete evidence that the efficiency gains and reallocations identified in the 2004 Gershon Review delivered considerable savings without affecting quality.⁵ Before the election, only £10.8 billion of efficiencies identified in the 2007 Comprehensive Spending Review (CSR) had been delivered by autumn 2009 – that is, more than two years into a four-year efficiency drive, less than a third of the £35 billion savings initially promised by 2009-10 had been achieved.⁶

The new UK Government has pledged to accelerate deficit reduction over the next parliamentary period, with the main reduction from cutting spending rather than raising taxes.⁷ In May 2010 the Government committed to making £12 billion of savings in this financial year (2010-11), of which £6 billion will be 'recycled' to protect spending on priority areas. In the emergency Budget in June 2010, the Government announced up to £61 billion in savings would need to be made by 2014-15 (based on £44 billion a year by 2014-15 from the deficit reduction plan inherited from the previous Government, with additional reductions in departmental spending of £17 billion by 2014-15). For comparison, this is approaching two-thirds of the current annual budget of the NHS in England.

To meet this target, many government departments will see their discretionary current spending (called 'Departmental Expenditure Limits' or DELs) cut by significant amounts. By 2014-15, the net savings required outside of 'protected departments' could amount to up to 25 per cent of the budgets of some departments compared to 2010-11.

To begin to put these figures in context, if this is applied to the Ministry of Justice (responsible for courts, tribunals and prisons in England and Wales), this would mean a budget reduction of £2.28 billion by 2014-15. This equates to more than the annual cost of public and private prisons in England and Wales (£2.073 billion).

The scale of the savings required over the next few years stands in stark contrast to the significant and continuous increases in real terms spending on public services over the past decade. The savings required would reverse almost all of the increases in DELs as a share of national income since 1997. Making these savings will represent the tightest budgets since April 1976 to March 1980 and the first five consecutive years of real cuts since 1948-49. This will present a particular management challenge for a generation of public service managers who have limited experience of dealing with significant reductions in budgets.

The long-term challenges facing public services are also increasingly apparent

The urgent need to change our public services to address the deficit is compounded by deeper, longer-term challenges facing public services – major, seemingly intractable social problems that are already pushing services close to crisis and putting pressure on costs.

These challenges include:

- **An ageing population:** which will require significantly more care and healthcare, and the pension budget will soar. If current trends continue, delivering the level of public services we do now would cost an additional 4 per cent of GDP by 2030.⁸
- **Rising levels of obesity:** rising rates of obesity are putting an enormous strain on the NHS, with current costs reaching £4.2 billion per year.⁹
- **Crime and social cohesion:** 40,200 adults leave prison every year after serving a short sentence. Over two years, 73 per cent of these will re-offend. Each offence leading to reconviction costs the criminal justice system on average £13,000 with total costs close to £11 billion a year.¹⁰

Even before the recession, the combined pressures of demographic shifts, more complex social and behavioural conditions and changing public expectations were revealing the limits of traditional approaches in public services.¹¹ Current

public services deal predominantly with the symptoms of conditions rather than prevent their development, and they neglect a number of unmet public needs that have deep effects on health and wellbeing.¹² The NHS is the clearest example of this, still investing the large majority of its resources in acute care rather than preventative approaches despite the majority of demand coming from managing long-term conditions.¹³

Further, the emergence of networked technologies and digital communication tools are transforming the way we consume other goods and services and putting higher expectations on government to deliver more flexible, responsive and personalised public services.¹⁴

The short-term need for savings in public finances is a consequence of a long-term shortage of innovation and reform

The current short-term need for significant savings is part of a longer-term crisis facing traditional ways of organising and delivering services. In the same way that the economic recession reflected a deeper structural crisis in the financial sector and our economy generally, so the crisis in public finances reflects deeper structural issues about our public services.¹⁵

Despite decades of reform, capital investment, and relentless effort on the part of professionals, the way that public services are organised today is still largely a legacy of the post-war Labour Government and the Thatcher Governments' more market-oriented changes of the 1980s – of relatively standardised and uniform services delivered to a mainly passive public.¹⁶ The dominant tendency has been towards incremental reform and improvement, rather than a more fundamental reorganisation of a new 'welfare settlement' (the reasons for this lack of radical reform are further explained in Part III).

One way to demonstrate this is to compare the benefits of innovation in other sectors of the economy and infer the cost of an 'innovation deficit' in the public sector. Given the profound differences between the private and public sector it is important to caveat the comparison. But as a thought

experiment, the results hold some striking implications.

The Office for National Statistics's Centre for the Measurement of Government Activity has spent several years developing output and productivity measures for UK public sector activity. Although this is a difficult and contested process (not least since judging the value of public sector outputs is difficult because people usually do not pay to consume them), the ONS has attempted to reflect service outcomes in their measurements, not just activity. Their results showed a significant decline in public sector productivity over the past decade.

This work can be used to estimate the effect on the current deficit of more successful public service innovation in the past. It is difficult to estimate the economic effect of more effective innovation in public services, but one approach is to look at the benefits of innovation in other sectors of the economy, which are increasingly rigorously measured.¹⁷ NESTA's *Innovation Index* demonstrated the productivity benefits of innovation in the UK private sector between 1995 and 2007 was between 1.8 and 2.3 per cent.¹⁸ This figure can offer a proxy for the amount of innovation that we might expect to see from radical innovation in the public sector.

Applying these figures for the impact of innovation to the ONS's figures for UK public sector input and output is revealing. It implies that if we had more actively innovated in our public services over the past decade, in 2008-09 we would have spent £63 billion less to achieve the same results (equivalent to reducing the size of the current annual deficit by more than 40 per cent).

A sharper understanding of how public services need to be better – in meeting people's needs and solving problems – could enable government and public service organisations to identify where existing approaches are struggling as a result of a mismatch between service design and public need. There is an analogy with declining markets in the private sector, where products and services from an existing method of production no longer meet consumer demand or expectations. Just as newspapers are being forced to move content online and music industries adapt to new consumer behaviours, public services

that don't meet public demand will only become increasingly unaffordable.

Of course, public services didn't cause the global financial crisis of the past two years; indeed public services have had to bear the burden of the subsequent recession and the resulting higher unemployment in particular. But the scale of the savings we now need to make from public services is so large – and the task will be so difficult – because public services weren't designed to resolve today's complex and more personal problems. The costs of managing these problems will only rise. The only route to sustainable savings in public services is through having an impact on underlying costs, for example the rising price of ill health or offending behaviour. Not doing so will leave us with 'hollowed-out' services, failing to meet demand and solve problems for citizens.¹⁹ Projected demands derived from an ageing population will outpace realistically available resources in social care, health care and pensions services.²⁰

Where demand has continued to rise despite increased investment – such as the demand for prison places outgrowing institutional capacity – continuing with the same approach makes little sense. Similarly, where productivity has stabilised or indeed fallen alongside increases in funding, such as productivity in acute care in the NHS, withdrawing funding without also instigating radical reform will only undermine the ability of these services to cope with current (let alone future) demands.

Government has a choice in how these cuts are made

The new UK Government has committed to reducing the deficit in a fair and responsible way, and it has expressed its intention to ensure that cuts protect the part of the population who rely on public services the most, the same people who have been hit hardest by the recession.²¹ Fragile local economies are most at risk from cuts to public sector jobs.²² This is not just a moral argument, but also an economic one. As the social consequences of a recession – the effects of mental and physical health or family breakdown from increased

unemployment – lag behind economic ones, cuts are likely to accelerate already unsustainable demands for services. The economic recession could easily be followed by a deep ‘social recession’ of rising demand but fewer resources.

But there is another challenge in how government chooses to make these cuts – how they help or prohibit services to innovate and respond to changing conditions. Businesses that recognise recessions as periods of market restructuring can focus on transformation, changing the way in which they operate and building new opportunities for growth. These businesses recognise the cuts or investments they make in innovation as a choice; they define the way in which they will operate in the future, especially if they are used to replace outmoded products and business practices.

Whereas leading companies maintain or even increase investment in innovation in a recession,²³ in public services it is more likely that preserving ‘business as usual’, albeit with substantially reduced resources, will win out over radical reform. In a crisis, businesses can make the mistake of retrenching into ‘core’ products and markets, or focusing on ‘safe bet’ ideas rather than the radical innovations that can re-shape markets.²⁴ Similarly, policymakers could defend high-profile services or programmes at the expense of more radical but more effective preventative and local community-based solutions to social problems.²⁵

There is therefore a parallel here with the risk of undermining the economic recovery through misplaced cuts to spending. Public services urgently need to innovate to transform services, but there is a likelihood that cuts will further marginalise innovative approaches and take us further away from where we need to be in the future.

In the next section, we sketch out a more positive future for public services in more detail – setting out how and where services need to be different – and highlight some examples that are demonstrating ways to get there.

PART 2: THE DIRECTION OF TRANSFORMATION - WHAT PUBLIC SERVICES SHOULD LOOK LIKE IN THE FUTURE

Even before the financial crisis, there was broad agreement between political parties, public service workers and citizens that public services need to look very different in order to meet changing demands and expectations.

Future public services need to be centred around citizens and responsive to their needs, work in very different ways to engage and involve the public and communities, and be designed and managed much more locally. Services should strive to engage actively with citizens, communities and frontline staff to nurture more social responsibility and capabilities (or ‘social productivity’).²⁶

In this section, we set out how public services should look in the future, with some illustrations that indicate this radical shift in practice.

A fast-forward to the future - ‘people-powered’ public services

Many policymakers and those who work in public services would agree with the need for a transformational shift to preventative approaches and drawing more on people’s own capabilities to solve problems. Public services need to work much more closely with citizens, communities and frontline staff – an approach which NESTA has described as ‘people-

powered public services’.

- Public services need to engage citizens more actively in their design and delivery. Given that many of today’s most difficult and disruptive issues are intricately linked with people’s lifestyles and behaviours, actively working with citizens to solve problems and reduce demand needs to be the ambition.
- Public services need to work more closely with communities to draw more effectively on unused or underused assets to achieve publically agreed goals. Communities can purposefully inspire action on an issue and motivate and support lifestyle change. In tackling issues such as climate change, mental wellness and social behaviour, working better with and through communities can have a powerful impact.
- Public services need to draw on the innovative potential of frontline staff. Control over the financing and organisation of public services needs to be held much more locally. Frontline staff are closer to the issues, so often have a precise view on where and how services can be better (and cheaper).
- And public services need to make more effective use of social, low-cost technologies to communicate and collaborate with people. In other sectors, the web and digital tools are transforming the way in which people use and make products and services. Though these tools are starting to affect public services – how we learn, how we teach, how we care for ourselves and each other – we’re only beginning to realise their potential.

The direction of transformation – re-thinking the ambitions for public services

This ‘people-powered’ vision prompts re-thinking about the ends that services set out to achieve, and sharpens our sense that the current means are often outdated. There is considerable consensus across the political spectrum that public services should move from services that react to

problems to those that prevent and solve them. This means a shift from management and acute care to the prevention of problems, from institutionalised provision to community-based care, from containment to rehabilitation and supported lifestyle change.²⁷

In health, given the scope for prevention and better self-management of long-term health conditions that are the main pressure on the NHS, the predominant model would shift from acute care to preventative interventions.²⁸ As Jennifer Dixon, Director of the Nuffield Trust, recently argued: *“too many people are admitted to hospital when their ill health could have been prevented by better GP care, managing their own conditions or through greater social care support.”*²⁹

Similarly, the purpose of the criminal justice system could be radically re-orientated to reduce offending behaviour rather than struggling to manage it.³⁰ The new UK Government has proposed to lead a ‘rehabilitation revolution’ in the criminal justice system, fundamentally refocusing the purposes of offender management to reduce re-offending.³¹ More broadly, there is substantial research to recommend new approaches to reducing re-offending, shifting justice services towards preventing recidivism and tackling the root causes of crime.

Mental health services could do more to promote wellbeing and mental wellness, working with individuals and communities to prevent people slipping into crisis and helping them to recover more effectively when they do. Social care services could build people’s capabilities and wellness in older age, rather than reacting when need becomes most acute.³²

These fundamentally different ambitions for public services demand radically different approaches. The UK Government has started to set-out its vision for public services that serve and support a ‘Big Society’, where citizens, civil society groups and social enterprises work with and alongside the state to respond to social challenges. In the Big Society, many aspects of what now constitute public sector activity would be opened up to a wider range of social and community organisations and charities to deliver innovative, diverse approaches that respond to public demand.³³

There are many examples of local authorities and services that are making these kinds of radical shifts. Lambeth Council in London has already taken steps down the path towards a 'mutual' model of service delivery, bringing in local residents and employees as owners in a cooperative, with much greater control over service design. As the first 'John Lewis' Council, Lambeth is offering tax rebates to residents in exchange for helping to run services. Lambeth is looking at a 20 per cent reduction in funding in the forthcoming spending period and as its Chief Executive rightly acknowledges: *"no council can afford to keep on doing what it's been doing in these circumstances."*³⁴

There are many examples of radically innovative approaches already delivering better services for less money

New approaches to delivering public services are already being put into practice – often achieving savings of between 20 and 60 per cent over traditional approaches – far more than can be gained through efficiency drives. Given the depth of the financial crisis, these kinds of savings *cannot* be unrealistic. Where services will need to save a significant proportion of their budget, starting with service redesign is more likely to deliver the reductions necessary rather than progressively shaving off 5 per cent per year through greater 'efficiency' or incremental reform.

For example, Camden Council in London recently undertook a radical reform of its housing services – in an approach it came to call 'Housing Options Transformation'. Camden was experiencing unsustainable demand for housing services, resulting in long waiting lists and high dissatisfaction rates among service users. Homeless clients were being moved around from one temporary accommodation to the next, pushing demand to other parts of the service.

To address the issue systematically, Camden led a service redesign process based on the choice-based lettings approach first trialled in Holland. Choice-based letting or 'bidding' puts applicants in a more active role in the housing distribution process, highlighting the relative restrictions on provision and

dispelling myths around who benefits from social housing. A comprehensive, flexible IT system supported the shift in service design, enabling Camden to cut-back on officer time and reduce failure demand.

Due to Camden's ambitious pursuit of this approach, the number of accepted statutory homeless applicants is now in single figures each month. There have been positive knock-on effects from providing better privately rented accommodation in improving quality of life for tenants, improvements to safeguarding services and the Every Child Matters agenda, and Camden is currently looking to extend this approach to other

Table 1: An overview of case studies

| Innovation | What they did | Cost saving | Benefits |
|---|---|---|--|
| Local Area Coordinators, Western Australia | Enlisting the community to provide social services | 35 per cent reduction from traditional social care provision | 58 per cent greater take-up rate of social services, better community care |
| Restorative Justice, Somerset | Tackling recidivism through community action and deliberation | Every £1 spent on Restorative Justice saves £9 in reconviction costs | Average 27 per cent fall in reoffending rates |
| Justice Reinvestment, Connecticut and Texas | Redirecting prison investment to local prevention projects | \$30 million saved over two years, of which \$13 million reinvested (Connecticut) | 87 per cent fewer incarcerations over two years (Texas) |
| North Karelia Project, Finland | A major public health initiative to target unhealthy lifestyles | Significant reduction in spending on Coronary Heart Disease (CHD) and lung cancer | Around 70 per cent reduction in coronary conditions and improved life expectancy |

areas of service provision.

Throughout this report, we showcase four further case studies of where such bold, radical reform of service delivery has led to considerable savings and better outcomes for service users: Local Area Coordinators in Western Australia; Restorative Justice in Somerset; Justice Reinvestment in Connecticut and Texas; and a major public health initiative in Finland. All of these approaches save money through better accessing and exploiting non-state resources, intervening early and diverting spending, understanding more precisely what service users need and creating incentives for sustainable lifestyle change – particularly through community intervention.

Local Area Coordination – radically reorganising services to make them better and cheaper

In Western Australia, as in other developed countries, the costs of residential social care far exceed the cost of care provided for people in the community. Faced with constrained resources, the Western Australia government took a radical approach to rebalancing the provision of residential to non-residential care in providing services for people with learning disabilities. They appointed government-trained ‘Local Area Coordinators’ (LACs) to act as a local point of contact in a community, to plan and organise care services around the needs of the service user. Local Area Coordinators have been able to draw on people’s existing resources and networks and to build specialist skills for self-management of care amongst individuals, their families and friends.

Rather than waiting for people to fall into crisis, Local Area Coordination is designed to help people stay strong and make communities more resilient in coping with needs.³⁵ With the introduction of Local Area Coordinators, the Western Australia government realised a 35 per cent cost saving from traditional social service-led approaches to delivering care. Per capita costs were only \$3,316 given

the distributed reach of each LAC and the low set-up costs of the programme. From their position within the community, LACs were also able to access traditionally hard-to-reach people, advancing the take-up rate of community services and preventative care.

Given their impressive impact and the increasing body of evidence indicating better outcomes for service users, LACs are already being piloted in Scotland and in Middlesbrough. The Scottish Government is currently undertaking a review of the programme which is starting to generate remarkable cost implications. The total cost of a social care package in Scotland is on average £35,525 compared to the £250 per capita cost of the LAC programme.³⁶ By decentralising the coordination of services, having a deeper and more personal relationship with service users to determine their needs and simplifying access to care, Local Area Coordinators are having a radical effect on the way in which services are organised, keeping costs down and improving the lives of people who use them.

A report from NESTA and the Innovation Unit³⁷ presents numerous examples of ‘radically efficient’ approaches such as these in more detail, which achieve savings of between 20 and 60 per cent whilst still improving outcomes for citizens. Rather than starting with efficiency, these services start from the perspective of trying to improve outcomes and how resources can be marshalled to achieve this goal. They focus on ‘better’ as a route to ‘cheaper’, in the recognition that only by being much more effective can services be much more efficient.

Many alternative approaches to delivering public services have developed as social enterprises, charities and community-based organisations, operating outside of the state. However, it is not enough to stimulate a market of alternative providers to state-funded public services: the approach taken has to encourage a wider diversity of approaches. For the most part, market mechanisms in public services are used to drive down prices,

outsourcing to other competitors to do the same job but for less money. Outsourcing for innovation – where contractors have the liberty to use entirely new means to achieve the contracted outcomes – implies a different kind of competition.³⁸

If a social enterprise sets up as an alternative to a traditional public service, there is a risk that the state will choose to replicate the approach and inadvertently crowd-out new entrants. Rather than acting as competition, the question is how these new *approaches* can effectively and usefully ‘disrupt’ services in the mainstream. This is the competition that counts, as Schumpeter argued, the competition: “...*from the new commodity, the new technology, the new source of supply, the new type of organisation... which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations*”.

Bringing these more effective approaches into the mainstream of public services will obviously be a long-term process, both in continuing to develop new approaches and in transforming existing public services accordingly. It is a challenge of innovation, not just implementation, that is of a continuous and evolutionary process, dependent on developing, testing, selecting and ensuring these new approaches to public services are adopted at a large scale.

Cuts should be made in a way that prompts the transformation of public services

Despite this growing consensus on the need for radical change, it is unclear how we reconcile the pull of a new settlement with the austerity ahead. There is a genuine risk that amid contracting resources, attempts to preserve business-as-usual will win out over radical reform and innovation.

Even in a period of increased investment, closer partnerships with local communities, citizens and frontline staff in the design and delivery of public services – conditions necessary for these kinds of innovations to develop – were a difficult sell to central government. It requires a move away from ‘best practice’ towards a more diverse and potentially more disruptive approach. In an age of austerity, reverting to a ‘command and

control' approach to fiscal consolidation risks crowding-out innovation even further.

Instead, saving money needs to be done in a way that gives space to more of the kind of services we want to end up with. In order to do so, we need to understand more about how the system in public services stimulates and supports innovation (or rather, typically doesn't), and how to turn the current crisis into a vehicle for transformation.

PART 3: EXISTING APPROACHES OFTEN INHIBIT THE TRANSFORMATION OF PUBLIC SERVICES

Policymakers have highlighted the need for innovation in public services for some time.³⁹ As part of this, there has been an increasing recognition that public services need to work much more closely with citizens, communities and frontline staff – an approach that NESTA calls ‘people-powered public services’. So why hasn’t innovation in public services led to their transformation? Why has the overwhelming focus been on the incremental improvement of existing approaches rather than the more radical change to *what is done*?

There are two main reasons for this: a set of relatively familiar issues related to conditions within public services (such as incentives and risk); and some less remarked upon but arguably more important barriers that would strike a chord with Schumpeter, specifically the tendency of entrenched and established ways of doing business to crowd out radical alternatives.

Previous analyses have focused on cultural and institutional factors that inhibit innovation in public services

The past three decades have seen many examples of institutional innovation in public services, from more autonomous schools and hospitals to new forms of access to services such as NHS Direct.⁴¹ Some government departments have set up specific initiatives and funds in support of innovation, and there are many examples of local authorities

and voluntary agencies pioneering new approaches to public services.⁴¹

Yet the public sector is typically less engaged in innovation than the private sector, especially the radical innovation that leads to transformation.⁴² Previous explanations for the lower significance of innovation in public services often focus on a range of systemic conditions. At a service level, this means a lack of funding and commissioning for new approaches and restrictive performance management and targets. Public and media scrutiny of 'failure' and the short-term demands of the electoral cycle can lead to risk-aversion and a lack of openness in evaluating the success or otherwise of new approaches. Over-specified regulations and procedures can inhibit initiative, discretion and appropriate risk-taking by civil servants and public service employees, coupled with a lack of incentives to act in innovative ways.

At a wider operational level, the scale and complexity of the public sector, including siloed departmental responsibilities, makes it very difficult to innovate across service areas. The costs of changing institutional arrangements are prohibitive, and there remains a general lack of expertise in innovation and a weak 'innovation culture' across government.⁴³ Such barriers have been frequently acknowledged, and despite some excellent and focused innovation efforts, a culture of innovation is not pervasive in most public services.

When the public sector does engage in innovation, there is a tendency towards large-scale, technology-led projects with significant upfront costs – the former government's NHS IT project ('Connecting for Health') being the most prominent example.⁴⁴ Such innovations are dominated by senior decision-makers and management; contributions from lower-level staff tend to be marginalised.⁴⁵ The innovations also tend to be incremental rather than radical, that is, complementary to existing approaches rather than breaking decisively with them. At the same time, public sector reform can be driven through too quickly, effectively experimenting on the whole population, unlike parts of the private sector where small-scale experimentation and testing is more often a continuous and iterative process.

For these reasons, and despite increased support, the experience of many innovators suggests that getting radical new approaches adopted at any scale by mainstream public services remains remarkably difficult. This is the case whether or not these approaches have been developed inside or outside of public services; in other words, it isn't just a cultural issue of resistance to ideas 'not invented here'. Frontline staff within public services – as well as civil society groups – have developed hundreds of highly innovative projects with and by service users and communities – but very few have made it into the mainstream, in the sense of becoming much more widely adopted or indeed the 'norm'.

This is crucial because, in contrast to the fairly centralised, technocratic nature of much public sector reform, as suggested in Part II many of the radical new approaches that public services will need to adopt are likely to be developed with and by frontline staff, the users of services and communities, and harness new forms of digital technologies. For example, developing more personalised and patient-centred services in healthcare will depend on working with users more closely to understand their needs and how they can play a greater part in improving their own health and managing their own conditions.⁴⁶ More broadly, local community-based initiatives can be effective at encouraging and supporting the behaviour change which is critical in taking a more preventative approach to issues such as public health, climate change and criminal justice.⁴⁷ More open and widely distributed approaches to innovation will be necessary to create these types of services and initiatives.

To try to counter this, NESTA and other organisations have focused on strengthening the 'supply side' of innovation in public services – for example by experimenting with stronger processes to test out ideas at an early stage, helping innovators think about potential 'markets' and impact, and evidencing their impact in more rigorous ways. However important this support has been – and it has been crucial to the development of many radical innovations – these approaches often still struggle for wider adoption.

Restorative Justice - starting with social solutions to reduce demand for services

Restorative justice is an approach to justice already being used in many communities in the UK. Restorative Justice sets up a safe, controlled environment where the anger, trauma and guilt surrounding an offence can be addressed and redressed by victim and offender. It takes into account the social, psychological and emotional damage caused by offending and encourages offenders to assume active responsibility for their actions, drastically reducing re-offending rates. Encouraging discussion about an offender's motivations exposes other social issues where useful intervention could be made - patterns of unemployment in the area, drug or alcohol problems or underperformance in schools, for example.

In the Somerset town of Chard, local Community Justice Panels are incorporating some of the most effective practices in restorative justice, encouraging local people to take responsibility for justice and building community capacity to rehabilitate and understand the needs of offenders. The Community Justice Panels deal with cases sent by the police, local authorities and housing associations where offenders have accepted that they are guilty. Dealing with these cases in a restorative manner diverts offenders from incarceration, tackles local fear of crime and prevents re-offending. Chard's practice remains specific to the local area, but the principles of the Community Justice Panel have been adopted across other parts of Somerset and have spread to Sheffield.⁴⁸

Evaluations of restorative justice practices by the Ministry of Justice have found an average fall of 27 per cent in re-offending rates and the Restorative Justice Consortium estimates that every £1 spent on restorative 'Conferences' (where the offender's family and peers are brought together to map out a plan to prevent re-offending) saves £9 in reducing reconviction costs.⁴⁹ As every offence leading to reconviction costs the UK justice

system on average £13,000, with the overall costs reaching £11 billion, more preventative, restorative approaches could have transformative effects.⁵⁰

Radical new approaches struggle because they can't topple incumbent approaches

NESTA's experience in supporting and working with innovators suggests that there is a more fundamental explanation for the difficulty of spreading and adopting radical new approaches in public services. This explanation echoes Schumpeter's understanding of how transformation happens in private sector markets, and suggests that the barriers in public services may be more structural than 'cultural'. What primarily stops the spread of radical new approaches in public services is the entrenched position of traditional – or incumbent – approaches.

For example, NESTA's experience of helping clinicians to develop new services in the NHS suggests that all too often it is existing services and the related organisational and managerial structures that stand in the way of radical change. NeuroResponse, an innovative Multiple Sclerosis service, shows how genuinely empowering patients and clinicians can unleash radical, far more cost-effective ways of meeting patients' needs. Yet both the service (supporting patient self-management and offering direct access to expert help) and the way it was developed (devised and led by a frontline member of staff) remain highly unusual in the NHS. The radical changes needed to redesign services around patients or to set-up effective preventative behaviour change programmes are hard to achieve within existing NHS organisations, in part because new approaches question or even conflict with existing services and processes.

Similarly, NESTA's Innovations in Mental Health programme worked with a number of clinicians in mental health trusts around the UK, to develop frontline-led new approaches to serving and working with users. In many cases, even with the availability of outside support, valuable innovations were

left undeveloped or underexploited because of the difficulty of achieving change in a large, complex but fundamentally conservative organisation.

The end result is that innovation remains patchy across the NHS – and this in a service that is generally regarded as being at the forefront of recognising the importance of innovation and promoting it. As in many other public services, innovative ideas thrive in specific places, but innovation is not pervasive. Existing approaches retain their grip.

This underlying issue – the resistance of incumbent approaches – has three main aspects. Innovators in public services struggle to ‘change the rules’ that favour incumbent approaches and so transform services. It is difficult to challenge the position of incumbent approaches due to a lack of effective processes for decommissioning and redirecting resources, and there is the ‘incumbency bias’ in terms of evidence that makes commissioners reluctant to invest in alternative approaches. These three aspects are dealt with in turn below.

i) Innovators in public services struggle to ‘change the rules’

Innovators in public services are often unable to change the assumed objectives and outputs of a service – to ‘change the rules’ – and yet this is crucial to radical innovation.

Sometimes this takes the form of specific rules that inhibit the development and implementation of radical alternatives. For example, education, child protection and health and safety legislation and procedures have inhibited the development of many ‘mutual nurseries’ projects, that is, nurseries that involve parents and communities as opposed to relying only on professional staff. Scallywags Parent Run Nursery in Bethnal Green, East London, nearly closed as result of these procedures because of the sheer difficulty of coping with them.

Scallywags is highly affordable for nearly everybody; it costs just £2.50 an hour, significantly lower than comparable childcare provision in London. This is possible because parents do much of the work. They manage the nursery and take decisions, as well as being a crucial part of the staffing. Creating the conditions for the co-production of childcare required Scallywags to navigate a minefield of policy obstacles

which, while meant to protect children, had the consequence of pushing away the skills and capabilities of parents who wanted to participate in their children's care.⁵¹

Other approaches are not so much blocked by rules and procedures but are largely unrewarded or within mainstream public services or struggle to receive funding, and so fail to spread widely. Paxton Green Group Practice, on the borders of Southwark and Lambeth in south London, is a seven-partner practice and one of the largest practices in south east London. It uses timebanking, a mutual volunteering approach which enables people to swap skills and support with one another. Paxton Green raised some money from the local Primary Care Trust to help establish the timebank, and has now been joined by 11 other local organisations, including local public services.

But despite the recorded benefits of this approach - which takes pressure off GPs by enabling some patients to receive appropriate support and increase their social activity in the community - only a tiny minority of GP surgeries have adopted similar approaches (of the more than 10,000 GP surgeries in the UK, it is estimated that fewer than 100 have timebanks attached to their practices). As with Paxton Green, those that do tend to rely on grants from central funds or charitable donors, rather than mainstream health funding. Even then, most donors tend to be focused on supporting one narrow problem or group, whereas the kind of innovation represented by the Paxton Green Time Bank supports broad solutions that reflect how people actually live their lives.

This is a common problem for new approaches that take a more holistic approach and which are based on building and strengthening relationships between users of services. In some cases, because of their very different models of provision, such approaches can struggle to be recognised as 'services' at all by potential funders.

For example, KeyRing is an initiative which enables vulnerable adults to live in their own homes.⁵² Each 'network' of nine KeyRing members is supported by a locally based community worker, who offers ten hours of support a week. But crucially, the community worker encourages supportive interactions between members, to promote self-reliance and mutual

support, based on the expertise and skills of the people who use the service. As well as contributing to each others' support, each member typically also contributes to the local community. This produces a net saving of £1,414 per person compared to alternative support.

Yet funding remains a huge challenge for KeyRing. Commissioning rarely recognises services based on mutual support. The result is that KeyRing has to work twice as hard to build relationships with local authorities to persuade them that their model gives disabled people more control and genuine empowerment, while offering significantly lower costs than assisted residential placements. KeyRing has managed to reach more people not by centralising and reducing the scheme to a series of deliverables in order to fit with funding, but by 'scaling out' – seeding small local networks much more widely.

This issue – the ability of innovators to 'change the rules' – is important because doing so is often critical to the success of radical new approaches. As Schumpeter noted in private markets: *"...the function of entrepreneurs is to reform or revolutionize the pattern of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on."* Though inevitably more difficult to introduce than incremental innovations, radical innovations pay-off precisely because they create 'new rules' by changing what kind of product or service is delivered, to what specification, at what cost, to meet a particular need. In this way, innovators can transform markets, with incumbent businesses being forced to adapt or fail.⁵³

What the above examples point to, is that the situation in public services is typically very different, as summarised in Table 2.

In public services, innovators can rarely change the rules because the rules – for example what services are duty bound to deliver – are often set by policymakers and enforced by audit and inspection regimes.

Table 1: Differences between innovation in private markets and public services

| Private sector markets | Public sector/public services |
|--|--|
| Innovation secures strategic advantage | Improvement secures advantage |
| Innovation is almost continuous | Innovation (top-down reform) is 'stop-start' |
| Innovation has many dimensions | Innovation is often one-dimensional |
| Radical innovation pays off | Incremental improvement pays off |
| Radical innovation creates 'new rules' | 'Rules' stay the same |

This has often been legitimate and desirable. Policymakers have mandates gained through democratic processes to formulate the intended objectives that public services are meant to achieve. Audit and inspection authorities then evaluate the performance of public services against these objectives.

However, this has also meant that providers have often been unable to redefine performance criteria, thereby inhibiting the development and adoption of radically different approaches. The system, in terms of funding, commissioning and evaluations of performance, is too often configured only to recognise and reward existing 'solutions'. (In part this is because audit and inspection regimes have developed far beyond their original role of assuring that public money is being spent appropriately, to identifying how services can be incrementally improved and evaluating the progress of services against these models of improvement).

When innovation is explicitly supported, it is policymakers who often decide the form of the 'innovations' they want to see and then try to create the incentives for providers to supply

these innovations. In other words, policymakers in effect try to determine the nature of the 'market' in public services, even in their desire to encourage 'new approaches'.

As an example, Mark Johnson, Founder and Director of User Voice, has experienced the challenge of mainstreaming a new, different approach within the criminal justice system. User Voice is an enterprise supported by the Aldridge Foundation which works with prisoners to improve how prisons operate and to reduce recidivism by offenders once they are released. Yet this approach is struggling to integrate with existing services. Mark puts this partly down to entrenched investment in traditional approaches, and the dominance of a particular type of success criteria.⁵⁴

What this points to is that many mechanisms that are intended to improve public services and hold them to account, actually inhibit the change that we need. The situation in public services, in contrast to private sector markets, obviously represents a major advantage to incumbent approaches and explains why they remain incumbent even in the face of changing needs.

The result is an overall lack of radical new approaches that grow and are widely adopted. Consequently, innovation is slower because of insufficient opportunities to transform the 'market' in many public services. Fundamentally it is this *weak demand* that causes a lack of innovation – and so limited funding, support and expertise – not the other way around. The people who work in public services are no less inherently able to innovate than those in private businesses; they just have less immediate incentive to do so.

Logically then, it is not enough to strengthen support for innovation in public services. Equally, just creating more 'vehicles' for innovation, from mutualised services owned and operated by frontline staff to Social Impact Bonds, is unlikely to ensure that much more innovation unless more significant structural changes are made alongside them. Innovators in public services need greater scope to 'change the rules' in the same way that private sector entrepreneurs can. This is why moving to outcomes-based commissioning is potentially so significant, because it represents one way of allowing providers (whether public, private or voluntary sector) much

greater scope to change the rules and so develop innovative approaches.⁵⁵

ii) There is a lack of effective processes for repurposing and redirecting resources

For radical new approaches to be adopted at scale requires the repurposing and redirection of resources towards these approaches and away from existing approaches. In public services, incumbent approaches are entrenched because there is a lack of clear and stringent processes for repurposing or decommissioning services that would help to determine the replacement of existing approaches by better approaches.

This is most apparent in the area of preventive approaches. For example in health, policymakers (especially incoming governments) have often heralded the importance of making a fundamental shift towards a more preventive health service. Yet preventive or 'public health' has remained the poor relation of traditional acute care, representing much less than 10 per cent of NHS resources. Public health has been repeatedly marginalised as 'health promotion'. Important though this is, it is far short of a broader and more radical interpretation of public health which would require the re-purposing of health services and the re-allocation of resources away from acute care and towards community-based and -led initiatives to improve health and wellbeing. For understandable reasons, and despite some important initiatives in preventive health, improving acute care has remained the focus of policy, funding and practice.

This is why radical innovation is often developed outside of mainstream public services (for example, by civil society groups), but struggles to get adopted by (or to replace) the approaches that dominate mainstream services.

In health, a well-known example is the Bromley-by-Bow Centre, a social venture in London's East End.⁵⁶ It established a healthy living centre, bringing together GPs, nurses, arts, education, sheltered housing, support and care and a three acre park. The centre is based on the principle that what contributes to health is a broader set of factors such as friendship, material and emotional security and mutual support. It is a contemporary

version of the pioneering Peckham Health Centre that attempted a radically holistic approach to health in the 1930s, and which was closed down in 1948 because of opposition from senior medics.

Although there may now be greater recognition of the value of this much broader approach to health, Bromley-by-Bow still represents a marginal approach in terms of the NHS. The centre has raised some money from the state and it does of course include a mainstream service in the GPs surgery, but despite its success it has not become a mainstream approach in the health service.

Similar issues exist in the private sector, of course. Although there are many examples of existing businesses that have transformed themselves or their markets through radical innovation, radical innovations are more likely to come from new market entrants, who are freer to develop new business models and target new customers than incumbents. Existing businesses can become locked into their existing technologies, organisational structures, business models and related investment, encouraging them to focus only on incremental product improvements ('sustaining innovations'). Entrepreneurs can use this as an opportunity to not only break into markets, but actually create whole new markets.

This also explains why many innovations that start from within public services – such as the idea for the online patient feedback service Patient Opinion, developed by GP Paul Hodgkin, or Working Rite, a support and mentoring service for the long-term unemployed – subsequently set-up as social enterprises outside of mainstream services with external advice and support. Even then, such innovations face 'competition' from mainstream services.

For example, Patient Opinion, a privately-run web service which sends patients' feedback about their NHS treatment to subscribing organisations, has had to contend with the Department of Health's official NHS Choices website with its budget of about £20 million a year. More recently, as a result of the government release of data, the two sites have found a way of working together. Patient Opinion is one of the first independent services to take reviews from NHS Choices and

combine them with its own data. Further, Patient Opinion has entered into a partnership, with NHS Choices for feedback from users of mental health services.

For some, the simple answer is to open up many more state-delivered public services to much greater private competition – to create private-dominated markets in public services. But a Schumpeterian-inspired analysis of innovation in public services actually points to a more fundamental issue than types of providers, namely the *design* of the ‘market’ in public services. Schumpeterian-style progress is unlikely to occur unless providers are in effect able to change the rules of provision and the ‘market’ is designed in such a way that it encourages and rewards the replacement of less effective approaches by new and better approaches.

This is borne out by the experience of introducing more competition in the provision of public services, whether by creating mechanisms to compare the performance of public sector providers (for example, more aptitude tests for pupils and league tables for schools), or allowing more private or third sector suppliers (for example, in local authority services). While some of these reforms have generated important improvements in efficiency and performance,⁵⁷ market-oriented reforms have generally not been successful in creating the more radical entrepreneurialism and transformative change experienced in many private sector markets.

Providers have often been paid per activity (for example, patient treated or call handled), so there is little incentive for them to reduce this through radical innovation (quite the contrary). Such narrow performance management has encouraged incremental improvement rather than radical service redesign. It has focused largely on marginal efficiency within existing service delivery models, thereby in effect reinforcing incumbent approaches, rather than stimulating more radical ideas for service redesign. It has also introduced highly complex and expensive compliance and auditing regimes, which have increased bureaucracy but have often provided misleading data.

While a greater diversity of provision can be important for innovation, the more important point is to try to ensure a

stronger and more flexible 'market for ideas', both inside and outside existing mainstream public services. The experience so far of markets in public services has suggested that it is possible to stimulate a greater variety of alternative providers without stimulating a greater diversity of approaches, and it is the latter which is ultimately most important in transforming public services to cope with changing demands at much lower cost.

There is a further interesting echo here with the development of Schumpeter's understanding of innovation in private sector markets. Whereas Schumpeter's early work emphasised the importance of entrepreneurs and new market entrants in developing radical innovations, his later work focused on large corporations. The latter have far more resources to devote to innovation, and so stand more chance of leading market transformations. Schumpeter suggested that: *"...a market structure involving large firms with a considerable degree of market power is the price that society must pay for rapid technological progress."* The same could be true of large-scale mainstream providers such as the NHS. In other words, the equivalent of a market transformation is only likely to occur if existing large-scale providers can in effect transform themselves to incorporate more radical approaches.

iii) 'Incumbency bias' makes commissioners reluctant to invest in alternatives at large-scale

There are many examples of radical innovations that are increasingly well-evidenced, demonstrating cost savings and better outcomes over traditional models of service delivery (a few have been included in this report). Even so, commissioners of services tend to stick with incumbent approaches. The answer can be found in 'incumbency bias'.

Innovative approaches are by definition much less familiar than existing approaches. This means that the evidence base for new approaches is often regarded as weaker than for incumbent approaches, despite the apparent advantages of the former and an increasing recognition of the deficiencies of the latter. For example, most commissioners and funders have a very specific view of what constitutes 'success' for a service, often based on the delivery of particular types of help or advice to

users. But radical innovations often challenge this.

Headway East London is a charity that runs a day centre that has pioneered a new approach to rehabilitation for people who have suffered ‘acquired brain injury’. Headway’s approach is based on ‘co-production’ – the idea of equal and reciprocal relationships between public service professionals and service users that help the latter to develop their capabilities.⁵⁸ Headway looks at their ‘patients’ according to what they can do, not just what they can’t do, and then builds on this. The members (rather than ‘patients’) of the service have been increasingly integrated into the professional work of the centre. They help to run aspects of the service, mentoring new members, doing assessments or inductions or organising projects. Just as the Expert Patient Scheme has shown in the NHS, patients are often experts in their own condition, but in this case they can also provide vital support to each other. However, to many funders, Headway’s approach is sometimes seen as ‘unproven’ and cannot attract financial support as easily as more conventional support mechanisms, even though it is clearly more effective on a range of measures.

This type of situation creates a bias for incumbent approaches more generally: the resilience of incumbent approaches means that there is less large-scale radical innovation, which means there is less evidence in support of large-scale radical innovation, which reinforces the position of incumbent approaches. Another way of putting this is that the *gaps in evidence for radical innovation are often a function of incumbency*, rather than why incumbent approaches are the best.

Compare this with the situation in private sector markets. Businesses that recognise their future depends on innovation don’t require evidence to decide whether it should form an important part of their strategy and operations. They know it needs to. This is both obvious and fundamental. Businesses invest in innovation in ways that maximise their chances of developing radical new products – often in a wide ‘funnel’ of early-stage innovations that tapers to just a few well-tested and trialled new products ready for large-scale roll-out.⁵⁹ But crucially they set different evidence demands depending on

how advanced an innovation is in this process. Businesses invest lots of small amounts in promising ideas, but they invest a lot more in what they reasonably think will be a few market-changing new products. This is more efficient, reduces risk, and ensures the greatest chance of success.

Of course, the disruption implied by radical innovation and transformation is difficult to cope with. In public services it might imply closing part of a local hospital to invest in other types of more preventative, community-based healthcare. There are serious reasons of public and political accountability that explain why incumbent approaches tend to persist. The recent controversy over the plans for the reconfiguration of London NHS services illustrates the difficulty of reconciling a strategic approach to reforming and rationalising public services with the need to secure public and political support for change.

Nonetheless, we need to find ways in which we can over time replace incumbent approaches with new, more effective and more efficient approaches. The scale of the savings now required is so great that the choice isn't between radical reform and defending existing services, but between radical reform and existing services being overwhelmed by demand at the same time as suffering from reduced resources.

In what can be regarded as a moment of market transformation in public services, we should be focusing rather more on the equivalent of the 'market-changing new products' that are far more likely to be more effective in reducing costs (for example, preventative approaches), and rather less on marginal efficiencies within incumbent approaches. We should also be focusing on radical innovation within existing providers, alongside thinking about how to encourage new providers.

PART 4: GOVERNMENT SHOULD USE THE NEED TO SAVE MONEY TO TRANSFORM PUBLIC SERVICES FOR THE LONG TERM

“The carrying into effect of an innovation involves, not primarily an increase in existing factors of production, but the shifting of existing factors from old to new uses...”

Joseph A. Schumpeter, 1939

Many businesses have learnt to use changing conditions – whether recessions or periods of market restructuring – as a major spur to innovation. In a similar way, government should use the short-term challenge – the need to save unprecedented sums of money – to create much stronger conditions for innovation in public services. This isn’t about continuing with incremental reform, but using the disruptive effect of spending cuts to re-think and redesign services.

Destruction – creative or otherwise – is unacceptable given the vital role that public services play in society. Considerable social harm would result from the breakdown of the public services that we depend on and pay for – far from the ambitions of any political party. Wholesale service closures without reform would also push demand elsewhere, undermining the actual efficiency and legitimacy of any cuts. Nonetheless, the dominant model of uniform services delivered to passive citizens is unsustainable.⁶⁰

Many public services will continue to be provided free at the point of delivery and paid for through general taxation. But, given the need both to make cuts and for radical innovation, it

may be necessary to decommission some services in order to enable new, better approaches to grow and develop.

The question is how this is done. In his analysis of private sector markets, Schumpeter recognised the importance of a 'managed transition' between old and new forms of production: *"there is certainly no point in trying to conserve obsolescent industries indefinitely; but there is point in trying to avoid their coming down with a crash and in attempting to turn a rout, which may become a centre of cumulative depressive effects, into orderly retreat."*

It is then critical that the way in which decisions to save money are made in the short term keeps sight of the kinds of public services we want in the future. The scale of savings required is such that this represents a moment of 'market transformation' in public services, akin to what happens to private sectors in recessions or during periods of rapid technological advance. Instead of undermining progress towards the kinds of services we need for the future, government should make cuts in a way that prompts new approaches to develop, grow and spread.

This won't be easy, and there are significant political challenges in the management of change on this scale. National policymakers need to be bold and provide the necessary strategic leadership and drive for a 'new welfare settlement' in public services equivalent to the founding of the post-war welfare state.⁶¹ On the ground, local ownership and public engagement is required to lead change and experimentation. Both of these must be aligned to achieve the transformation we need.

The actions taken now will set the course of transformation for the next decade

The cuts made by government will start to define the way that public services respond to the challenges of the future and their capacity to develop new approaches that are both better and cheaper. The real danger now is that cuts are made to public services that take us further from the kinds of services we need. Some might say that now is not the time, that saving money needs to come before we think about transformation. The

argument here is that transformation and saving money cannot be separated.

The UK Government has set out its intended process for determining reductions in spending, including a process of consultation in summer 2010 and a spending review in autumn 2010. As part of this, the Government has stated the need to think innovatively about the role of the state in society, including considering new and radical approaches to public service provision.⁶²

This was in part the approach during the Canadian fiscal consolidation processes in the 1990s, where budget constraints were introduced and a Programme Review, governed by a special minister and committee, was used to comprehensively assess the role of government. Tough constraints induced an atmosphere of 'crisis' – a factor credited with the programme's success – and the relative independence of the review panel prompted deeper questioning into the purpose of government programmes and their effectiveness.⁶³

Crucial to this process in the UK will be a clear message and public dialogue about the future of public services – how services need to look and act differently to meet current and future needs. The case for reinventing public services has been made before; the point is to use the current situation to take a major step towards services that deal with the causes of problems before they arise, and to welcome fresh thinking about what these services should look like.⁶⁴ It is possible to make such radical shifts – the case of Justice Reinvestment highlighted in this report shows what can be achieved with both political commitment and community engagement.

Government should also use this process to define 'new rules' for public services, for example to revise performance and measurement mechanisms so that they align with these new visions for services, rather than their current focus on incremental improvement within existing models of service delivery. This means challenging our current perspectives on needs or social problems, in order to change the very nature of demand. Policymakers should start with how services can be radically *better*, rather than starting with where to make cuts and savings.⁶⁵

By establishing and promoting clear outcomes that public service providers have to achieve, government should allow greater flexibility in the way in which these objectives are met. Setting out the 'new rules' for public services would be the route to radically re-orientating accountability measures, performance metrics and targets so that they foster innovation rather than limit it (for example by being focused on outcomes rather than processes).⁶⁶

Justice Reinvestment - from coping with crime to preventing it

Faced with insatiable demand for prison places, the State Departments in Connecticut and Texas took a more systemic approach to preventing re-offending. With 1 in 100 American men behind bars, spending on incarceration in the US has grown faster than any part of the public sector except Medicaid. In Texas and Connecticut, prisons were at breaking point despite significant state investment and re-offending rates and probation violation were an expensive problem.

Justice Reinvestment was an initiative first trialled in Connecticut and subsequently adopted in Texas. Both states rapidly redirected monies from funding prison places to strengthening community infrastructure, education, job training, drug and alcohol treatment and mental health care. Local government was given much more autonomy to allocate funding and short-term prison sentences were reserved as a last resort.

Connecticut saw a steeper decline than any other state over a two-year period, whilst the crime rate continued to drop, and reinvested \$13 million of the \$30 million saved in community-based pilots.⁶⁷ In Texas the prison population stabilised and the state was able to reinvest \$241 million otherwise spent on prison construction in community initiatives. Overall savings of \$233 million were a result of avoiding having to build new prisons.

The new UK Government has begun set out new rules in some areas, such as the ‘rehabilitation revolution’ promised in criminal justice and the emphasis on improving public health alongside healthcare services, but such emerging visions are not yet apparent in many other crucial areas of public services. For example, as suggested earlier, criminal justice more generally should be focused on new approaches to reducing offending behaviour, while social care should build people’s capabilities in older age rather than reacting when need becomes most acute.

These visions should form the basis for the Comprehensive Spending Review scheduled for the autumn, providing a far clearer strategic rationale for where and how reductions in budgets could be made and identifying the necessary steps towards the transformation of public services in these areas.

Of course, this also needs to be a public debate. Given the need to make deep savings, there is a serious danger of profound professional and public anger about reductions in provision (even if it is part of a shift to alternative forms of provision). The public could be more of an ally in transformation only if there is much greater transparency in the process and if information about the need for reform is freely available and openly discussed. Public understanding and acceptance of change would grant legitimacy to the process, allowing government and public service organisations to be bolder in making more radical reforms.

Three policies for radical innovation

In taking forward this process, there are three things that government should do to ensure that a more positive chance for radical reform can grow from the challenging context of cuts:

- Put the right systems in place for resources to be repurposed towards new, better approaches.
- Radically reform commissioning to encourage new community and local provision.
- Replace a culture of audit with a light-touch process of assurance.

First, government should provide the right systems so that resources can be repurposed towards new, better approaches

'Protecting frontline services', however understandable, could entrench incumbent approaches, marginalise new approaches and block radical reform. It is the equivalent of private sector businesses ring-fencing existing investment in existing products and markets, rather than looking for opportunities on the basis of new technological or social conditions. Instead of looking to protect the most commonly valued areas of public spending (such as spending on health or education), government should seek to protect (and in many cases improve) outcomes – the actual impact that services have on the ground, however these outcomes are delivered. Without this, the services that matter most will be the least reformed after the next few years.

Constricting budgets ought to be used as a spur for transformation across all departments, *especially those that the public values the most*. Every organisation and provider ought to reconsider how it interacts with its 'customers' – the public – how it makes use of and invests in new technologies and consumes increasingly limited financial and environmental resources. Some public service organisations will see this as a threat, others as an opportunity to re-evaluate their corporate purpose and how they operate. Indeed, the most forward-thinking local authorities are already doing this, for example by using customer insight techniques and developing services based on co-production (equal partnerships between public service workers and the public that recognise the latter's capabilities as well as needs).

Radical innovation often involves changing the way the frontline works, often dramatically. The examples of NeuroResponse or the Camden Housing Options Transformation programme discussed above both involved redefining the frontline entirely, while both improving the service and making it cheaper. Protecting the frontline from change or reconfiguration would have rendered both these innovations impossible.

Given the obvious differences between private markets and public services, creating the space for transformation needs to be a carefully managed, deliberate process of transition,

focused on the social purposes of services and where we want to end up in the future. Government should enable departments and senior public service managers to make strategic cuts on the basis of the new visions and overall budget reductions, with the right systems in place for resources to be repurposed from outmoded or less critical services towards new more effective and efficient approaches. This would support a more rigorous culture of experimentation and risk in public services.

‘Failure regimes’ are one system that could be reconfigured to better enable this. The NHS already has failure regimes that identify where services are unsustainable, but current regimes are focused on identifying and correcting the underperformance of existing institutions within existing objectives. The 2009 NHS Performance Framework protects service continuity, rather than providing routes for decommissioning services that are failing to meet public need. To prompt a more fundamental shift in the ‘dominant design’ of health services – from acute to preventative care – there need to be sustainable, legitimate routes to decommissioning or reconfiguring approaches that inhibit innovation.

Government should also take advantage of new mechanisms that encourage and incentivise innovation, such as funds that blend investment from a number of different sources. Social Impact Bonds are a radical vehicle for this, as they align funding across the public sector and other socially-motivated investors to pay for improved social outcomes. Social Impact Bonds incentivise the expansion and coordination of services around a specific social issue, rewarding those that meet their target outcome. They offer a way for government to pay for prevention: consider for example a Social Impact Bond, the payoff of which is based on reducing overall crime rates in an area.

Structuring such a bond and making a charitable organisation a counterparty to it is one way to ensure that government money that would typically be locked into specific parts of the criminal justice system (such as the Courts Service or the prisons system) could be redirected to wherever the best and cheapest possibilities for reducing offending could be found. This may be in unexpected and innovative places.⁶⁸

Practical ways of doing this, in addition to the wider use of Social Impact Bonds, include making budgets available on a participatory basis for local neighbourhoods or patient groups (thus allowing them to be flexed between different silos of government spending), and building on the work of Total Place to identify opportunities to reallocate funding in local areas.

Government should also progressively divert funding from large-scale IT budgets towards more iterative, adaptive and social technologies that have the potential to transform culture and working practices as much as access to services.⁶⁹

Second, government should radically reform commissioning to encourage new community and local provision

The state has the potential to be a force for social innovation and enterprise, but current commissioning and accountability mechanisms are a profound barrier to this.⁷⁰ From Schumpeter's point of view, service commissioning ought to reflect the dynamic process of 'selection' in an innovation system, the process by which the system chooses the most effective and efficient approaches. A well-functioning selection system will rapidly and correctly choose the best innovation from a large variety; selecting too early risks undermining an innovation's potential, but selecting too late wastes investment in less effective approaches.

To mirror this, government should allow much more locally-led commissioning in public services to stimulate a more dynamic market in a diversity of new approaches. Local commissioning and service design can strengthen demand for new approaches, develop an evidence base, and build capacity locally to transform mainstream services and work more closely with private and social entrepreneurs and innovators to meet social needs.⁷¹

There is a broader analogy with the private sector here. Many businesses, cultural and social organisations are taking advantage of the current trend towards more widely distributed innovation. To maximise the potential of promising, early-stage ideas, innovative businesses add flexibility to their planning,

budgeting and reviews of innovation efforts and invest in a broader portfolio of ideas.⁷² To make this process more efficient, the most forward-thinking businesses are opening up their formerly internal R&D processes to their suppliers, customers and to other businesses.⁷³ NESTA has worked with a number of leading businesses to demonstrate the value of this so called 'open innovation', including Procter & Gamble, Orange, Oracle, Virgin Atlantic, Tesco, Orange, Pfizer and BT.⁷⁴

This shift towards more distributed innovation should be reflected in the public sector. The complexity and local specificity of today's big social challenges means that centrally led, technology-driven approaches are struggling to make an impact. Instead of assuming that the best solutions need to be determined, prescribed, driven or 'authorised' in some manner from the centre, policymakers should create more opportunities for more distributed innovation and look for solutions beyond established organisations and experts.

Public services should build a stronger pipeline of innovations and draw on open and 'user' innovation – inviting and supporting innovation with and by the public – to unlock the tacit knowledge and ingenuity of service users, frontline staff and communities. This form of innovation – innovation with and by the users of services – is the focus of NESTA's Public Services Lab. For example, through its Big Green Challenge programme to support communities to reduce their carbon emissions, NESTA has developed a broader approach to how many more opportunities can be created for local areas and groups to take action in response to pressing social problems.⁷⁵

Strengthening a more dynamic market of ideas in public services necessarily means giving more power to frontline staff, local communities and the public and much greater ownership of how services are designed and delivered. The current proportion of spending that is ring-fenced by central government gives local commissioners less flexibility in procuring the most suitable intervention.

North Karelia Project – locally led service design to transform public health

Finland in the 1970s presented a very different picture of public health from what it does today. Cases of coronary heart disease were remarkably high, and life expectancy was amongst the lowest of OECD countries. Close to crisis, the government launched a major initiative to draw on the expertise and initiative of grassroots and community organisations and facilitate the development of new, more preventative health services that encouraged healthy living.

The so called ‘North Karelia Project’ in Finland demonstrated the dramatic impact of low resource, community-based interventions that target general lifestyles and behaviour of the whole population – not just those at high risk. The Finnish Government reached right into local communities to understand the barriers to healthier lifestyles and devolved responsibility for acting on them to the communities themselves. By 2002, the annual coronary heart disease mortality among men had been reduced by 75 per cent. Lung cancer rates were 70 per cent lower, and life expectancy had increased by approximately seven years for men and six for women.⁷⁶

The North Karelia project tackled fundamental health problems from a grassroots level upwards and combined strong national engagement with community leaders and organisations to coordinate a horizontal, integrated approach to behaviour change. Government’s role was to facilitate and respond to community-based solutions, enabling a more flexible, personalised response to reducing factors compromising public health.

A lack of resources, incentives and time allocated to reflection and evaluation makes it difficult to go beyond existing examples of ‘good practice’, limiting capacity to invest in new approaches (which would in turn develop the evidence

base for their effectiveness). The tendency to outsource to big companies and preferred providers in public services can crowd-out opportunities to procure from small enterprises and organisations. Output-focused targets, monitoring requirements and application criteria can also limit the scope for new entrants and problem-solvers.⁷⁷

The recent development of new vehicles and mechanisms to enable innovation across departmental silos or funding streams is a reaction to this lack of flexibility. These vehicles include ways of flexing funding across and between departments, leveraging and developing the capabilities of users, communities and frontline staff and building a better culture of evidence. But introducing more vehicles for innovation needs to be done alongside the granting of greater freedoms to local bodies and frontline staff in delivering services, and giving communities and the public a greater stake in the ownership of services.

Government should allow much greater freedoms for innovators at a local level, radically simplify outcomes and resist codifying 'best practice' to allow more flexibility in local service design and delivery. This could also create a virtuous circle of innovation in public services, as learning from experimentation would build confidence and capacity for more locally developed and delivered solutions, bolster the evidence base for new approaches, and illuminate some of the existing barriers to innovation and how to remove them.

Finally, government should replace a culture of audit with a light-touch process of assurance

Given the expansion of audit and inspection that has accompanied previous increases in investment, the scale and scope of current regimes should be reduced as cuts are made. Specifically, assurance should be entirely separated from performance improvement and management, with the latter removed from the responsibility and remit of audit bodies.

Of course, there is an important role for regulation by central government and through independent agencies to ensure that public money is being spent wisely, but in so far as possible

this function should be one of assurance, not performance management. The latter should not be the role of central audit bodies. Instead this should be a mutual exercise, undertaken by public sector bodies with shared experience and challenges. What remains of the audit process should where possible be made trust-based, following the example of NHS Foundation Trusts, and complemented by the additional scrutiny provided by wider public access to financial and performance information.

One of the widely recognised barriers to innovation is over-centralised control and standardisation. As public budgets have grown, the role of central bodies has grown, often expanding beyond their core function of ensuring public money is spent wisely to take on a performance management role. The Audit Commission, the Commission for Social Care Inspection (CSCI) and other regulators have grown in their influence as investment in public services has increased, and increasingly measure a large number of detailed indicators in the process of determining whether a council, for example, qualifies as 'high performing'.

The UK Government has recently announced that a number of performance indicators and targets will be scrapped following the spending review, in particular many of the indicators currently in place for local government (the Comprehensive Area Assessment framework).⁷⁸ The outcome from the Total Place pilots was the promised removal of 18 indicators from the National Indicator Set (NIS) from 2010, although this only represents 10 per cent of the current NIS.⁷⁹

This trend should continue and be extended. Audit regimes should be increasingly limited to a pure assurance function, and this function should where possible be trust-based, with public bodies that do not fail to deliver important outcomes being given considerable trust in their declarations, in the way that Foundation Trusts in the NHS have been for over five years. This should be complemented by the obligation to publish performance and financial data online, in order to subject operations directly to the scrutiny of citizens.

This assurance function has two points of focus. First, particularly relevant given the move towards open data sets in

government, councils and other deliverers of public services should be required to publish their data, with assurance from central and independent bodies that this data is accurate and complete. Second, accounts should continue to be audited and inspected, with the results publically available. But lifting the weight of much auditing and inspection would at once strip away recognised barriers to the development of new approaches, and free up resources to refocus on delivery.

Transforming public services - a programme for radical change

Transforming public services for the better should form a major part of the effort to make the public finances more sustainable. Both are long-term issues, and they cannot be dealt with separately. Action will need to be taken immediately to begin to reduce the size of the public debt. Indeed, actions are already being taken across our public services. Programmes are being cut, staffing is being frozen or reduced, and plans are being made for further savings. The UK Government has also announced the first of its plans for cuts and the overall budget reductions for this Parliament.

But we have argued that these cuts should wherever possible be made with a view to what kinds of public services we want in the future, in particular how services can be re-designed so that they are better able to respond to rising demand. Cutting without considering how services can be transformed for the better is likely to be counter-productive, merely pushing costs onto other services or storing up even greater demand for the future.

We have set out the basic requirements for transformation, based on radical new visions for services: progressively repurposing and redirecting resources from outmoded services; encouraging local commissioning of new approaches; and replacing a culture of audit with one of assurance. If it is possible to establish a strong and shared commitment to transformation at all levels – from the top of government to the frontline of many services – then such a programme of radical change could be well underway in the period of two

Parliaments, which is to say ten years.

Establishing radical new visions for services would take up to a year, including the Comprehensive Spending Review scheduled for this autumn. During this time, cuts will still need to be made, but they can be informed by a more strategic rationale, especially since there is widespread agreement in many fields as to the necessary 'direction of travel', as noted here.

But, starting at the same time, there are also many innovations in public services that could be introduced relatively quickly and which would help to save money by beginning to reduce demand and so allowing initial cuts to be made with some safety. This is because they already exist somewhere in the 'system', they just haven't been widely adopted. Restorative Justice approaches are just one example; there are hundreds of others.

These local innovations – sometimes seemingly small-scale but nonetheless important – would also usefully point to the larger-scale models of public services that are required, and begin to build public understanding and support for the new welfare settlement.

Disinvestment and reinvestment would then take place in parallel. Some of the savings from disinvestment would be allocated to reinvestment in radical new approaches (the proportion will of course vary depending on the type of service and the investment required). The large-scale 'system' innovations included in this report, such as Local Area Co-ordinators and Justice Reinvestment will of course require more than one Parliament to be introduced fully, but as these case studies and others suggest, given the right level of commitment they could certainly be fairly well-established in the space of two Parliaments.

"The world of possible innovation cannot be mapped out."

Joseph A. Schumpeter, 1939

ENDNOTES

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NESTA is the largest independent endowment in the UK focused on innovation. Its mission is to support innovation to drive economic recovery and solve some of the UK's major social challenges. NESTA is a world leader in its field and promotes innovation through a blend of practical programmes, policy and research and investment in early-stage companies.

RADICAL INNOVATION IN PUBLIC SERVICES: NESTA'S LAB

To achieve radical innovation we need models that work much more closely with citizens, an approach which NESTA calls 'people-powered public services'. There are different ways in which citizens can interact with public services – as users of services, frontline workers in public services, communities, and in new configurations created by the web and digital technology.

Necessarily, this has a greater local emphasis – responses that are designed, developed and delivered locally are often better placed than central initiatives to understand local conditions and needs, and to engage citizens in taking action to tackle challenges more cheaply and effectively.

NESTA's Public Services Lab is running trials in all of the above areas, focused on practical techniques to make these different types of interactions between citizens and public services a reality so that they can be adopted and used by organisations across public services. For example, the Big Green Challenge has tested techniques for working with communities; Age Unlimited is experimenting with user-led approaches and we are working to increase the understanding of, and improve the environment for, co-production.



Innovating
public
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