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# The importance of strategic financial leadership in the UK public sector in a time of financial austerity

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Given the severity of financial pressures on public authorities, this report is concerned with how finance managers in public services are coping with the demands placed on them and how they can demonstrate improved value by providing more effective strategic financial leadership.

It considers how they are applying managerial approaches and solutions to the challenges of austerity and the role that the public sector finance function can play in this process.

# The importance of strategic financial leadership in the UK public sector in a time of financial austerity

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# Executive summary

## INTRODUCTION

Dealing with the effects of financial austerity is a key challenge facing the public sector in the UK and many other countries. In the UK, public authorities face, at best, a standstill on their funding growth and, at worst, substantial reductions in funding, in real terms, after decades of being used to annual funding growth. This is also happening at a time when the demands for public services are increasing, largely as a consequence of the ageing population.

Dealing with financial austerity has both significant political and managerial implications. A key managerial aspect of this is financial management and the role of finance professionals in leading and assisting public authorities in meeting the challenges of austerity.

Given the severity of financial pressures on public authorities, this report is concerned with how finance managers in public services are coping with the demands placed on them and how they can demonstrate improved value by providing more effective strategic financial leadership. It considers how they are applying managerial approaches and solutions to the challenges of austerity and the role that the public sector finance function can play in this process.

## SCOPE

The research primarily consists of case studies of public authorities, as well as a comparative review with the private sector. Three NHS organisations, five local authorities and two FE colleges were examined. It should be noted that there were no case studies in central

government or the devolved governments. Instead the researchers were reliant on indirect commentaries from various informed parties such as think tanks and retired employees rather than direct research which it was not possible to undertake.

The key issues considered concern vision and strategy, organisational leadership, and the roles of strategic finance managers in those organisations.

The research does not aim to draw statistically representative conclusions about practices across the public sector but aims to identify good practices that could be promulgated elsewhere. To do this, the project has developed and described basic models of strategy, organisational leadership and strategic financial leadership as the basis for assessing current practices in the public authorities that have been researched. Further details of the research methodology can be found in the main body of the report.

The research addressed four key questions.

1. What are the main challenges being faced by public authorities?
2. How are public authorities responding to the challenge of financial austerity?
3. How might effective strategic financial leadership assist in dealing with the challenges presented by financial austerity?
4. Is strategic financial leadership being applied effectively at the present time?

## HEADLINE FINDINGS

The challenges for public services today are unprecedented and the spot light is on finance professionals like never before. Given the pace of change and budgeting pressures it is critical that finance professionals working within the public sector are equipped with the rights skills to deal with the challenges ahead. Dealing with financial austerity poses different challenges for financial leadership than those encountered in a time of growth. Headlines from the research highlight:

### Challenges

The main challenges noted by public authorities were:

- the ageing population both in terms of the elderly and the very elderly
- lack of a robust evidential base in relation to service costs, comparative performance and effectiveness
- lack of political leadership at central and local levels.

### Vision and strategy

Public authorities have responded well to the financial challenges and have so far dealt with the reductions in funding without disastrous consequences for service standards.

Large-scale change has not necessarily resulted in reduced quality of services.

The strategies developed by the case-study authorities, although financially grounded, did not appear to have longer-term sustainability or maximise public value.

Public authorities anticipate further austerity, but strategic thinking about dealing with the next phase of austerity was largely under developed.

The approaches adopted in relation to the first phase of austerity were unlikely to be capable of being repeated and new approaches would be needed.

Little was discovered that could be regarded as service innovation.

Strategic working at the multi-agency level is generally seen as an important issue for service provision and public value, but in practice is often seen as 'too difficult'.

Multi-year budgeting was commonplace. However, in practice such projections were often 'broad brush' and represented extrapolations of the past.

Developing financial management skills among service managers was seen as vitally important.

### **Strategic leadership**

Strategic leadership is a theme which has been endlessly discussed and emphasised in the UK public sector for several decades, but the degree of progress that has been achieved is debateable.

Leadership approaches in austerity may need to be different from that in a period of growth.

There was evidence that some senior managers in the case studies seemed to lack academic training and/or practical experience in strategic leadership in any setting.

Strategic leadership (as opposed to

operational management) in multi-agency settings appears under-developed.

### **Strategic role of the finance function**

The finance function is at the forefront of strategic planning and in many cases the strategy is largely finance led. In these situations the finance function is trying to get the organisation more strategically focused at several levels in the organisation, but this is sometimes hampered by the lack of strategic management skills among managers at all levels.

Because of the pressures of austerity there is a perceived view that financial management capacity and capability are currently being eroded at a time when the task of dealing with austerity requires financial management to be strong and capable.

To deal with this, a number of the case study organisations researched have created small teams with concentrations of strategic financial expertise, which are separated, in some way, from operational aspects of finance.

For the finance function to be effective in providing strategic financial leadership it is essential for leadership to be given by both the finance director and the chief executive.

Strategic finance managers must adopt a dynamic rather than a passive approach towards financial leadership. This will involve less time at their desks and more time being out and about in the organisation and networking with managers from their own organisation and other related public authorities.

The relationship between the strategic finance manager and the non-financial

service manager is important. Strategic finance managers are developing more effective working relationships with service managers following what has been termed a business partnering model rather than a traditional accounting and financial control model.

It was notable that the organisations had deliberately focused on improving the financial skills and literacy of their non-financial service managers. The finance director should have lead responsibility for this.

There has clearly been a strong emphasis on the development of financial techniques. Improvements in costing systems and costing methods are one example of this while other examples would be improvements in multi-year forecasting and budgeting systems (and associated financial modelling) as an aid to developing and analysing longer-term strategies. The pressures of austerity place a premium on high-quality financial management and leadership and the use of techniques that are commonplace in world-class companies.

While many strategic finance managers are highly skilled there is arguably a lack of modern skills in particular areas. Some of these skills are technical and include cost analysis, financial forecasting, and financial modelling, while others are more behavioural and interpersonal, such as presentation, communications and networking skills.

There are barriers to good strategic financial leadership including a lack of political direction and a lack of support from within the organisation, particularly from boards and chief executives, who sometimes appear to have a separate agenda. Also, lack of



resources in the strategic finance function is an inhibiting factor. Lastly there is a lack of relevant quality-assured data and information.

### **Comparisons with private sector**

Entrepreneurial activities in public authorities were not always supported by relevant financial and risk analysis and with no planning around the long-term financial or reputational impacts. This in contrast to good practice in the private sector where such analysis would be rigorously applied in a competitive environment.

Some local authorities had been involved in very successful joint ventures with neighbouring authorities. However, during the research only limited examples were uncovered. Despite the potential for efficiency gains and cost savings to be made by the relatively simple task of combining common back-office functions (for example, finance transaction processing) these opportunities had been rejected by some authorities for unspecified or vague reasons associated with a perceived loss of control. Such opportunities were unlikely to have been rejected in the private sector for such spurious reasons.

In some organisations, control of budgets appeared to be poor, with a 'flexible' attitude taken to managing commitments and allowing overspends. Budgetary control is a very basic and widely used technique, and is of considerable importance in managing the use of resources. In times of financial constraint, budget management should assume a greater level of importance.

Most organisations provided good basic financial information through their finance teams. Some did not make use

of sophisticated modelling techniques or analytical tools to add value to that data and help make better decisions. This is surprising given the size and complexity of the organisations, the challenges they face, and the level of financial skill available to them internally or from external sources.

There were several examples of long-serving 'home grown' senior financial and executive staff, who had worked their way through the ranks within the same organisation and had spent several decades working in the same organisation. While clearly familiar with their own operating environment they sometimes demonstrated a limited appreciation of the need for a clear strategy and appeared to provide little innovation or leadership in solving the new challenges faced by their organisations.

### **Central Government**

Over the last five years, three critical reports have been published concerning financial management in central government. In-direct commentaries from informed parties obtained as part of this research confirms these findings.

There is a pressing need to strengthen financial management in central government, particularly in relation to strategic financial issues. Central to this is cultural change where professional economists and generalists begin to value the potential contribution that financial management can make to government decision making. It is to be hoped that the recently announced review of financial management across central government will seriously address the shortcomings identified by many commentators and will be a starting point for driving forward change.

## **RECOMMENDATIONS**

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Further useful work could take place in providing suitable training and development opportunities to help people develop strategies. This could include training courses, sponsored events, mentoring, and peer reviews.

Leaders of the finance function should always be at the most senior level of the organisation, as business partners.

Senior finance staff should be professionally qualified and widely experienced. Wide experience can mean in the private or public sectors or both, but brings a range of knowledge and perspective from which the organisation will gain.

It is important for senior finance staff to demonstrate strategic leadership skills as well as technical skills. These can be developed through both formal training and experience.

Finance managers should consider whether they are using the full range of up-to-date techniques to support their organisation. In the public sector of the future, a wider range of techniques will need to be used, particularly in the area of estimation and forecasting.

There is a need for finance (and other) managers to tackle the tasks of engaging the public more widely in the next and more difficult stage of the response to austerity.

# 1. Introduction

This report is concerned with the role of finance professionals in public authorities in dealing with austerity. It considers how finance managers in public services can demonstrate (and are demonstrating) enhanced value by providing more effective strategic financial leadership in testing times. This is important for a number of reasons.

Public services such as health, education, transport, policing are of great relevance and importance to all citizens.

We now live in an economic period referred to as one of 'austerity'. It will be argued below that this must be seen as a watershed in social and economic history and not a blip in the trend of increasing growth in public expenditure.

The finance function in public authorities is itself financed from public funds and is therefore subject to the same austerity pressures as all other public services. Hence it too must demonstrate what value it is adding to the provision of public services.

The report is structured as follows:

- A short background description of public services and how they are financed.
- The social, political and economic context in which the research was undertaken.
- An outline of the main themes of the research, namely: challenges, vision and strategy, strategic leadership and the strategic role of the finance function.
- A description of the research approach employed in this project
- The findings of research structured in line with the main themes already noted.
- The conclusions of the research and tentative recommendations.

## 2. Background to public services

The terms 'public services' and 'public sector' are sometimes used synonymously and sometimes used to differentiate between services provided by public sector organisations and (public) services provided by private or third-sector providers under contract to the public sector. In the UK, public services are of different types and can be provided by a range of organisations, as shown in Figure 2.1.

Figure 2.2 shows the composition of public expenditure in the UK, while Figure 2.3 shows the sources of funding for public services. Clearly, the mix of public expenditure and sources of funding will vary from country to country.

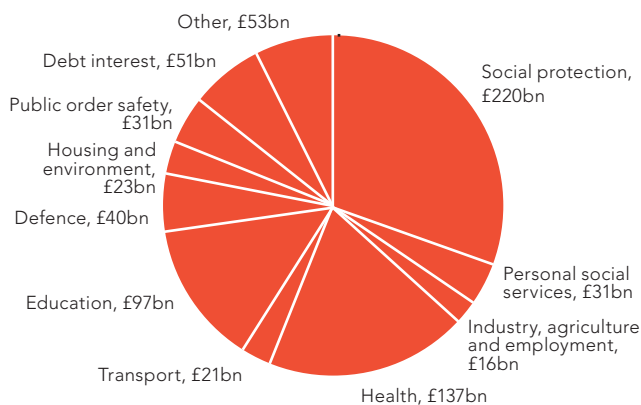
Three points should be emphasised:

- the dominance of UK public expenditure by social protection benefits, the National Health Service (NHS) and schools
- the dominance of UK public finances by centrally levied taxation and the low prevalence of locally levied taxes and other sources of finance, including user charges
- the growing importance of interest on accrued public debt as an expenditure drain.

**Figure 2.1: Public sector and public services**

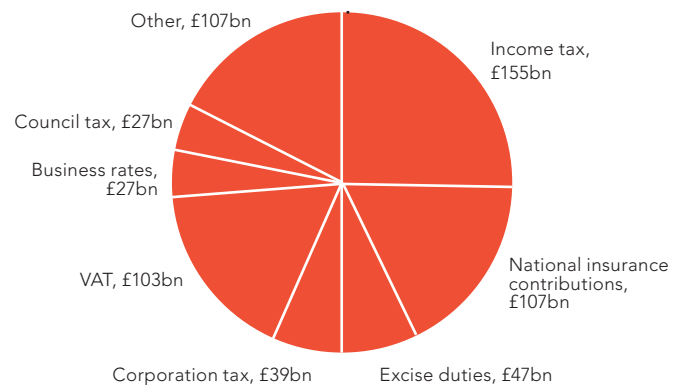
Organisations	Programmes of service
• Central government	• Health care
• Devolved governments	• Education
• Local government	• Social care
• Government agencies	• Defence
• QUANGOs	• Transport
• Education institutions	• Foreign affairs
• NHS organisations	• Welfare benefits
• Third sector	
• Private sector	

**Figure 2.2: Government spending 2013/14**



Source: HM Treasury, 2013.

**Figure 2.3: Government receipts 2013/14**



Source: HM Treasury, 2013.

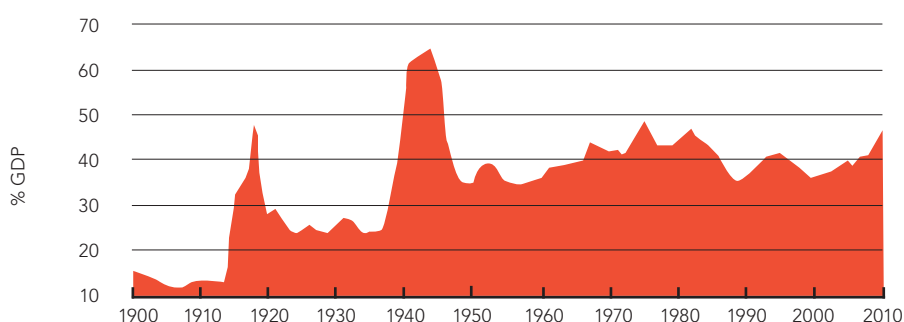
Figure 2.4 shows the growth of UK public expenditure (as a percentage of GDP) over a period of 110 years. The trend line shows an almost constant increase over this period. Also, it must be noted that since the GDP of the country has grown many fold over this period the absolute increase in public spending is even greater than shown.

Similar situations could be illustrated for many other developed countries and indeed Figure 2.5 provides some international comparisons.

It will be seen in most countries that the percentage of GDP committed to public expenditure falls in the range 40–55% with an average of 47.7%. The percentage in the UK is very close to the average.

If we look at the causal factors underlying this growth in UK public spending we can identify a number of distinct phases.

**Figure 2.4: UK public expenditure as a percentage of GDP**



Source: ukpublicspending.co.uk (2013).

**Figure 2.5: International public expenditure comparisons**

Government spending, % of GDP

	1870	1913	1920	1937	1960	1980	1990	2000	2005	2009
Austria	10.5	17.0	14.7	20.6	35.7	48.1	38.6	52.1	50.2	52.3
Belgium	na	13.8	22.1	21.8	30.3	58.6	54.8	49.1	52.0	54.0
Britain	9.4	12.7	26.2	30.0	32.2	43.0	39.9	36.6	40.6	47.2
Canada	na	na	16.7	25.0	28.6	38.8	46.0	40.6	39.2	43.8
France	12.6	17.0	27.6	29.0	34.6	46.1	49.8	51.6	53.4	56.0
Germany	10.0	14.8	25.0	34.1	32.4	47.9	45.1	45.1	46.8	47.6
Italy	13.7	17.1	30.1	31.1	30.1	42.1	53.4	46.2	48.2	51.9
Japan	8.8	8.3	14.8	25.4	17.5	32.0	31.3	37.3	34.2	39.7
Netherlands	9.1	9.0	13.5	19.0	33.7	55.8	54.1	44.2	44.8	50.0
Spain	na	11.0	8.3	13.2	18.8	32.2	42.0	39.1	38.4	45.8
Sweden	5.7	10.4	10.9	16.5	31.0	60.1	59.1	52.7	51.8	52.7
Switzerland	16.5	14.0	17.0	24.1	17.2	32.8	33.5	33.7	37.3	36.7
United States	7.3	7.5	12.1	19.7	27.0	31.4	33.3	32.8	36.1	42.2
<b>Average</b>	<b>10.4</b>	<b>12.7</b>	<b>18.4</b>	<b>23.8</b>	<b>28.4</b>	<b>43.8</b>	<b>44.7</b>	<b>43.2</b>	<b>44.1</b>	<b>47.7</b>

Source: Prowle and Latham (2012).

## HISTORICAL BACKGROUND

At the start of the 20th century, and for many centuries previously, the operation of public services in the UK and most other developed countries was largely limited to three areas of activity, namely:

- defence of the realm – expenditure on armed forces
- maintenance of law and order – police, courts, prisons, etc
- trade – regulation and promotion of trade matters.

Examination of the working life of the 18th-century UK prime minister, William Pitt the Younger, shows that his life was dominated by issues of trade, war and raising of tax revenues to finance those activities (Hague 2005). This is very different from today, when prime ministers will also have to regard health, education and pensions as being key political and social issues. Given the limited range of activity described above, not surprisingly public services, in the UK and other developed countries, were much smaller and more restricted in range than is the case today.

### First half of 20th century

During the first half of the 20th century, both the size and scope, public services started to grow substantially. The key factor here was the growth in the involvement of the state in promoting the welfare of its people. This was partly for altruistic reasons but it was also partly for the achievement of other aspects of government policy. For example, in the early part of the century, poor nutrition and poor housing were damaging the health

status of poorer people in society. In turn this was affecting the productivity of employees in industry and on the fighting effectiveness of conscripts in the army. During the First World War, recruiters had uncovered a dismaying fact that almost two in every five volunteers for the British Army were entirely unsuitable for military service on the grounds of poor health.

Not surprisingly, in the light of these facts, government came under pressure from industrialists and generals to do something about this situation. Consequently, within the UK, major welfare reforms took place that resulted in an increase in the size and scope of government involvement in social welfare issues. The main aspects of this were determined by two key pieces of legislation passed by the Liberal government of the day. These were the Old Age Pensions Act of 1908, which provided for a non-contributory but means-tested pension and the National Insurance Act of 1911, which provided a contributory but non-means-tested cover against sickness and unemployment for some classes of worker. Between the two world wars the development of the welfare state was somewhat limited, although there were key developments in the fields of social housing, pensions and education.

### Second half of 20th century

In the second half of the 20th century, there were three factors that contributed to the upward trend in public expenditure, leading to much larger and more complex public services that had a greater direct impact on the life of the average citizen.

### Increasing need for basic services

Once governments had become involved in various aspects of social

welfare they had virtually committed themselves to responding, to a lesser or greater extent, to increases in the need for services. Unfortunately, at the time of initial involvement, it was not always perceived that the needs, and hence demands, for services would grow substantially. Take, for example, the NHS. At the time the NHS was formed, there was a strong belief that the pool of sickness, and hence the need for health services, was finite and the provision of a certain level of resources to the NHS would meet all the health needs of the population. With the benefit of hindsight, that view now seems naive and current conventional wisdom is that the demands for health services are virtually unlimited.

### Creeping involvement in social welfare

There is now a general recognition that in a modern state, governments need to be actively involved in many aspects of social welfare (eg education, health, pensions). Politicians of the left and right may argue and debate the extent of that involvement but few politicians of the right would suggest that the welfare state be contracted back to pre-First World War levels. The Beveridge Report (Beveridge 1942) paved the way for the foundation of the modern welfare state, as it is currently known. Beveridge made recommendations for the development of comprehensive systems of social security and the development of a national structure of health services. Following the end of the Second World War the new Labour government embarked on a huge programme of improvements in social welfare, which basically involved the implementation of the Beveridge recommendations. The social security developments were underpinned by the passing of the National Insurance Act of

1946 and the National Assistance Act of 1948. Perhaps the flagship policy of this period was the creation of the NHS in 1948, which brought into public ownership large numbers of what were previously private or voluntary hospitals. In the area of education the critical development was the passing of the 1944 Education Act. This provided for a system of universal free state secondary education and provided the framework for the education services we have today.

### **State involvement in economic management**

During the period 1935–45 there was an increasing international acceptance that governments needed to have a much larger involvement in the management of their economies. This was the period of Keynes, the development of macroeconomics and the use of large-scale public spending in the US and Germany to boost flagging economies. Also, in the period immediately following the end of the Second World War, large parts of the UK economy passed into public ownership through the large-scale nationalisation of industries such as coal, steel, electricity and gas. These policies reflected the view of the then Labour government that public ownership of such strategically important industries was essential for economic management purposes. Subsequently, all these industries were de-nationalised through the privatisation policies of Conservative governments of the 1980s and 1990s. Since the Second World War it has been generally accepted that government should have a strong role in economic management. In practice, the extent and nature of that involvement are open to political and ideological disagreement, as the debate between

the merits of monetarism and Keynesianism in the 1980s illustrated. In the modern world, governments are involved in economic management in a number of different ways.

### **Start of the 21<sup>st</sup> century**

In 1997 a Labour government came to power after 18 years in opposition. Initially the new government abided by the public expenditure targets set by its predecessor but in subsequent years it presided over a substantial growth in the percentage of national income devoted to public services. To some extent, much of this growth in public spending might be regarded as 'more of the same'. For example, in the period 1999/2000 to 2007/08 spending on the NHS in England grew on average by 6.4% a year in real terms, well in excess of the rate of NHS growth in previous decades and well in excess of the average growth in public spending (4%) for the same period (IFS 2008). Some available evidence (Appleby 2007) suggests that a significant part of this growth in funding was not used wisely and led to a substantial reduction in the overall productivity of the NHS. Nonetheless, much of the growth in funding clearly went towards improving the range of health services and the ease of access to those services. In addition, a considerable proportion of the growth in public expenditure was also devoted to what might be regarded as 'new' areas of government activity. These are often controversial areas and many people would argue that the state is now getting too involved in areas of activity that have traditionally been private matters, or in forms of social engineering. Clearly such a large-scale involvement of the state in non-traditional areas has significant financial implications.

Following this historical account of growth in UK public spending, two of the key points to be discussed further below are that the onset of austerity means that the funds available for public services will be far more constrained than has historically been the case (see Figure 2.4) and in many cases will be reducing. At the same time, the demands for public services will continue to increase. This is an unprecedented historical situation.

### 3. Context of the research

It is important to set out this research and its findings in relation to various contextual issues. These help explain and provide a focus to the relevance and importance of the research and its findings. The issues discussed are:

- the aftermath of the Great Recession 2008/09
- the UK's economic situation
- the meaning of 'austerity'
- challenges for public authorities
- future prospects and fundamental questions about public services.

#### AFTERMATH OF THE GREAT RECESSION 2008/09

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In 2008/09 a large proportion of the world economy suffered economic recession. The scale of this recession (in both depth and length) was such that it has subsequently been termed the 'great recession'. During this period, most countries suffered either a formal economic recession (defined as two consecutive quarters of GDP decline) or some degree of economic slowdown (eg China, India). In most countries, the period of recession officially came to an end after an 18–24-month period but the level of economic output has barely reached the levels in existence before the recession commenced. Furthermore, it has left a number of lasting legacies, including the following concerns.

#### Shifting economic power

A shifting of economic power has occurred from the West to Asian economies such as China and India. For example, by around 2025, China is expected to be the world's largest economy.

#### Sluggish economic growth

In European economies and, to some degree, the US, economies have failed to return to what were regarded as 'normal' levels of economic growth of around 2–3% a year. There is also a lack of confidence among businesses and consumers and the possibility of 'beggar my neighbour' economic policies.

#### Public borrowing and debt crises (Europe and US)

It is normal practice in economic recession for government revenues to decline while government expenditures (eg unemployment benefits) increase and thus governments often generate budget deficits which they have to finance by additional borrowing. The scale of the great recession was such that government revenues plummeted drastically, leading to many governments generating large scale budget deficits which required huge amounts of borrowing and added to existing public debt. Such a position was unsustainable and many governments implemented austerity policies aimed at reducing their current debt levels both in absolute terms and as a proportion of GDP, by using expenditure reductions rather than tax increases as the key policy tool. Consequently, long-term growth in public spending may now be very limited.

#### Political turbulence and uncertainty

This exists in many parts of the globe, including Europe, the Middle East and South America. While this is not solely the consequence of economic factors, the aftermath of the great recession has probably had considerable impact.

## THE UK ECONOMIC SITUATION

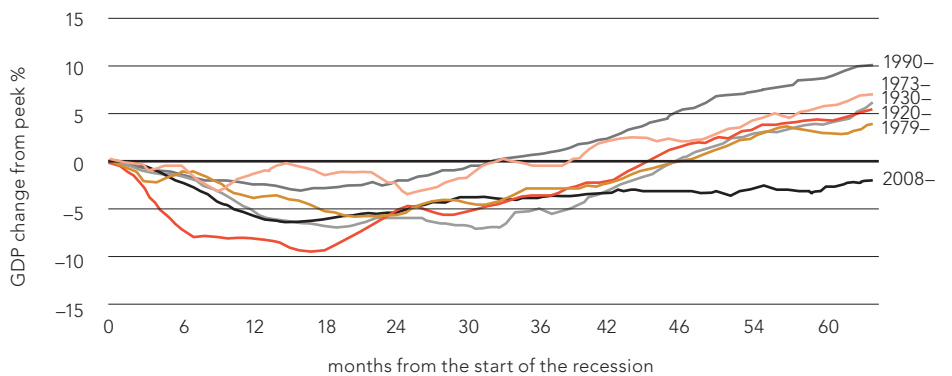
From 2008 the UK economy was in recession for six quarters and suffered a steep slump in GDP. This situation was exacerbated by the international 'credit crunch' and its global impact. The economy technically came out of recession in 2009 but subsequent growth has been sluggish and uncertain, as illustrated in Figure 3.1.

Since 2009, UK economic growth has oscillated either side of zero and has come nowhere near the levels of growth obtained in the previous two decades. The reality is that UK GDP has yet to return to the levels of economic output pertaining before the great recession. This situation is illustrated in Figure 3.2, which compares the 2008/09 recession with previous ones.

**Figure 3.1: UK economic growth 1980–2012**

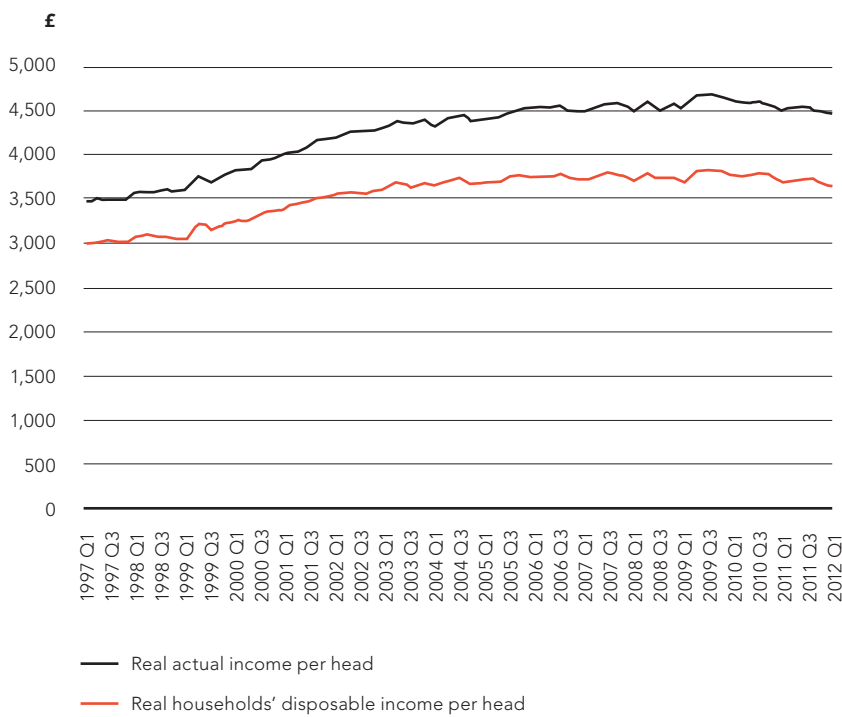


**Figure 3.2: The profile of recessions and recoveries since 1920**





**Figure 3.3: Households' real disposable income and actual income per head (constant prices) 1997–2012**



Also, Figure 3.3 shows that real incomes of individuals and families stagnated as a consequence of the recession and have subsequently started to decline.

The UK has fairly entrenched factors that are problematic for achieving a full economic recovery to pre-2008 levels. These include:

- high levels of personal debt, inhibiting consumer demand
- high levels of government debt, inhibiting counter-cyclical economic responses
- banks' continued reluctance to lend to businesses
- a fragile housing market.

Source: NIESR (2013).

## THE MEANING OF AUSTERITY

'Austerity' is now a commonly used term to describe the financial and economic environment in which many countries (including the UK) now find themselves. Although the detailed aspects of 'austerity' will vary between countries, a number of common themes can be found including the following.

There has been a history of running significant public budget deficits for a period of years up to the start of the global economic recession in 2008.

These annual budget deficits have been financed by borrowing, which has added to the stock of public national debt. This included taking on additional debt to support failing financial institutions, which notionally provided assets to cover the debt incurred. The value of these assets (usually shares) remains under question, given the persistent weakness of the banking sector.

The global economic recession commencing in 2008 has had an impact on government finances.

There has been only limited (or nil) economic recovery in the aftermath of the global economic recession discussed above

Large public budget deficits have continued to be financed through borrowing (thus adding further to debt) while at the same time governments have implemented policies of fiscal consolidation designed to reduce the size of annual borrowing requirements. This has usually involved some combination of tax increases and significant reductions in public expenditure. In carrying out this policy many countries, including the UK, could be said to be committing to the fallacy

of composition, which results in an attempt by all sectors of the economy to reduce the levels of debt simultaneously, and this becomes a mutually self-defeating exercise. In some other countries, notably the US, a more (albeit often unacknowledged) Keynesian response was initially undertaken aimed at increasing growth rates, maintaining tax receipts, and eventually diminishing both the depth and length of the recessionary impact.

In cases where certain countries found it difficult to borrow extensively and/or the cost of borrowing was unsustainable, then some form of financial bail-out was funded by the IMF and/or the EU, often with demands for significant reductions in public expenditure as a 'quid pro quo' This forced governments to reduce public expenditure, with social consequences. A number of these international bodies are now beginning to amend their views as a result of noticing the impact of these traditional 'sound money' policies on growth and social stability.

Figure 2.4, discussed in Chapter 2, shows that from 2000 onwards there was a significant growth in the proportion of GDP committed to UK public spending. Figure 3.4 shows that as a consequence of that increased public spending, the UK government was generating public budget deficits from 2002 onwards in a period when the UK economy was achieving reasonable levels of economic growth.

As the UK economy slowed down so the public budget deficit started to increase and when the UK economy entered recession in 2008 the budget deficit soared.

The UK coalition government came to power in 2010 and initiated policies aimed at eliminating the structural

budget deficit and associated borrowing over a four-year period. This policy involved increases in taxation, cuts in welfare expenditure and reductions in public expenditure programmes averaging 25% over the four-year period. Reductions of this level were unprecedented in modern times and most public sector managers had become used to planning in an environment of annual growth in resources. One expectation of the government's deficit reduction plans was that the UK economy would bounce back to pre-recessionary levels of economic growth, which would assist in

**Figure 3.4: UK public finances 1999–2009**

Year	Growth/ contraction in GDP (1) %	Government surplus/deficit as % of GDP (2) %
2009	-5.25	-12.8
2008	0.55	-5.5
2007	2.53	-2.7
2006	2.85	-2.7
2005	2.15	-3.3
2004	2.98	-3.7
2003	2.80	-3.7
2002	2.13	-2.0
2001	2.45	0.6
2000	3.90	3.7
1999	3.70	0.9

Source (1): tradingeconomics.com (2013).

Source (2): OECD (2013)..

the non-structural aspects of deficit reduction. In fact, as noted earlier, the UK economy has not bounced back, as had happened in previous business cycles, and for the last two years economic growth in the UK has oscillated marginally either side of zero. Consequently, the public budget deficit and associated government borrowing are still adding to the national debt. The absence of strong economic growth has rendered the original plan for deficit reduction unachievable.

It is now generally accepted by commentators that the original UK austerity programme will not achieve its original objectives of eliminating the budget deficit in the life of this Parliament. The recent 2013 spending review outlined further substantial cuts in public expenditure for 2015/16, which will fall in the next Parliament. Even so, during this period government borrowing will carry on and public debt will continue to rise. Many believe that austerity will extend well beyond 2016: for instance, Sir Jeremy Haywood, the permanent secretary to the Cabinet Office, has talked about a ten-year period of cuts in spending and the prime minister, David Cameron, has indicated that he thinks austerity will continue until at least 2020. A recent joint report from the Institute for Fiscal Studies and the Institute for Government also suggests that austerity will continue to at least 2020. These views seem reinforced by recent pronouncements from the Chancellor of the Exchequer that he does not believe that taxes will rise after the next general election, and that automatic pay increments for public employees are to be abolished. Austerity still has some way to run.

A consequence of these policies is that public sector organisations are having

to plan for a future where financial resources available for providing public services will contract annually for years to come. After that, the economic situation becomes unclear and it may be that the UK economy cannot achieve the levels of annual economic growth that it has achieved in the past.

### CHALLENGES FACING PUBLIC AUTHORITIES

Public authorities now face a number of significant challenges. In practice, the precise challenges will vary from sector to sector and these are summarised below.

#### Large cuts in public funding

The situation can be summarised as follows.

##### ■ Local government

Arguably, local government is the part of the public sector that is most strongly hit since it faces a real-terms reduction in funding of 30% over a four-year period with further cuts beyond 2014/15 as a consequence of the 2013 spending review.

##### ■ NHS

As regards public spending cuts, the NHS is one of those government programmes that are formally deemed to have its headline levels of funding 'protected'. The NHS is also charged with the task of achieving £20bn-worth of efficiency savings over a four-year period, so that these savings can be invested into new services or to develop existing services. Not the least of such services are those that will be required by an ageing population. Some suggest that further savings will be needed beyond the four-year period.

##### ■ Further education

The funding mechanisms here are complex and colleges gain funding from many sources, both public and private. Nonetheless, for most colleges public funding is likely to be the most significant source for the foreseeable future. Colleges will suffer significant downward pressure on funding through a raft of changes, including reductions in funding, reductions on programme weightings, reduced entitlements for free study for adult students, and substitution of student loans for public funding for adults over 24.

##### ■ Central government

Following the 2010 spending review, central government departments suffered large-scale reductions in funding, such that they have had to make substantial cuts and manpower reductions in their internal departmental expenditure. These cuts have not been equally distributed across government departments and some departments are 'protected'. The 2013 spending review has identified further substantial cuts in departmental allocations for 2015/16, which will again affect departmental internal expenditure and manpower.

#### Increasing demands for services

There are probably four main issues driving increasing demands for services.

The first relates to population size. The Office for National Statistics (ONS) projections suggest that the population of the UK will rise from 62.3 million in 2010 to 67.2 million by 2020 and 73.2 million by 2035. Such increases will clearly have implications for public service demand. Of course, the other side of the coin is that such an increase

in population may result in higher levels of economic growth and tax revenues to government, but this is uncertain.

The second issue relates to population structure and the well-known phenomenon of the ageing population. This phenomenon is brought about by:

- unprecedented and continuing declines in all-age, all-cause mortality rates, such that more and more people are living into their 80s, 90s and beyond, and
- substantial declines in the population fertility rate over several decades, such that the birth rate is now below the population replacement level.

These phenomena lead to what might be termed a 'population bulge', as shown in Figure 3.5.

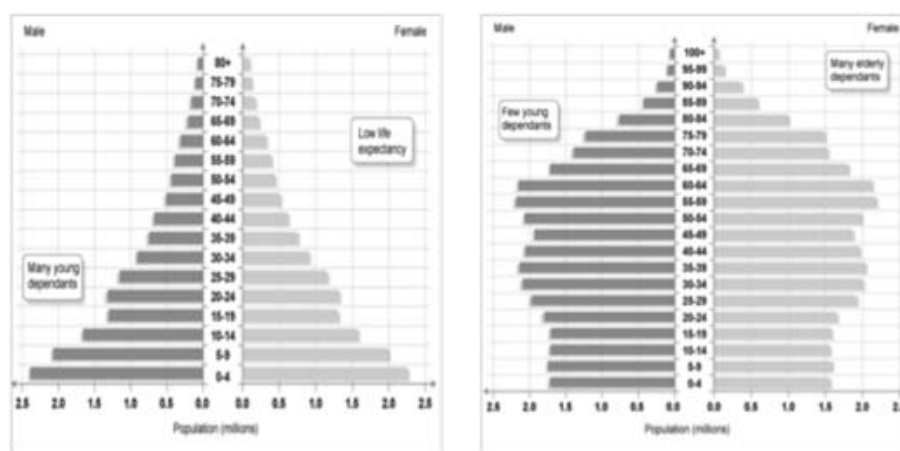
It is well established that a growing proportion of elderly in the population has resource consequences for a range of public services, most notably health and social care where the elderly consume a dis-proportionate amount of resources compared with the population average. Also to be noted are the rises in the prevalence of long-term conditions (eg diabetes, obesity-related conditions) in the general population, which have significant expenditure implications for the NHS.

The third pressure relates to developments in science and technology. Two aspects of this should be noted.

### Medical science and technological advances

There are continuous demands for increased resources in the NHS as a consequence of such developments. Consider the following: artificial joint

**Figure 3.5: UK national population projections – principal and variants 2010**



Source: Office for National Statistics (2013).

replacements, organ transplants, drug therapies, imaging techniques. These developments start in a research phase but this soon moves into widespread provision and what is research today becomes commonplace tomorrow. Before such scientific and technological breakthroughs took place the demand for such services was zero: the demand for heart transplants before 1967 was zero because nobody could do it. The existence and supply of such treatments itself creates and fuels the previously non-existent demand. More developments will become available in future and will create a demand for new services.

### The IT revolution

The IT revolution is well known and understood. In the last 30 years there have been a wide range of technological developments, such as personal computing, computer

networks, e-mail, and the internet. Such developments have truly changed the world and have revolutionised many aspects of human life, including the management of public services. These developments have had cost implications for public authorities and are likely to have more in the future

The fourth demand issue concerns broad societal trends such as family breakdown, loss of the extended family and the numbers of persons living in one-person households. Such trends have, over the last few decades, had major implications for public services and seem likely to have more in the future. Also to be noted are increased public expectations of what public services will provide and an enhanced sense of 'entitlement' which has its origins in the 'choice' agenda of the 2000s.

### Organisational inertia

Organisational inertia is a term used to describe the tendency of bureaucratic organisations to perpetuate established procedures and modes, even if they are counterproductive and/or diametrically opposed to established organisational goals. Public authorities are clearly bureaucracies (in a non-pejorative sense) with political and cultural constraints not found to the same extent in most private sector organisations. Consequently, overcoming such inertia in the light of austerity is often a major challenge for such organisations. There are several aspects to this.

The upward growth in UK public spending over many decades was

noted in Chapter 2. Even in the 1980s when the Thatcher government was in power, the so-called cuts in public funding that took place really involved reductions in funding growth, not absolute reductions in funding levels. Sir David Nicholson, the CEO of the NHS Commissioning Board, has regularly pointed out that before the current period there was only one year in which the NHS received a reduction in its central government grant (Murphy 2012). Consequently, the vast majority of public service managers working today are probably accustomed (even if they did not appreciate it) to an environment where their organisation obtained some degree of funding growth each year, and it is difficult to understand, accept and respond to the

change to an environment where there is no growth (and even reductions) in funding. Austerity and the lack of growth means that greater emphasis now has to be placed on considering how existing funds are being used and how changes can be made to cope with funding reductions and to improve the use of funds.

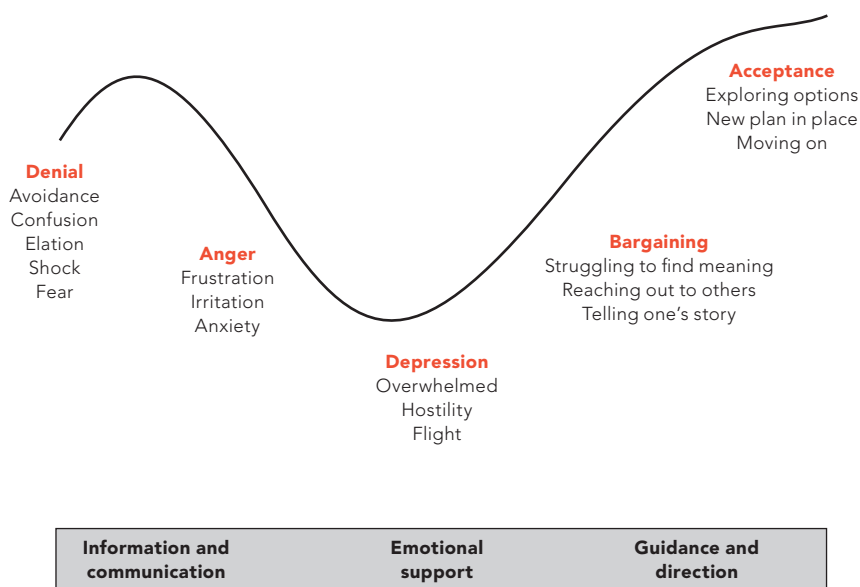
In some ways this situation has parallels with the Kübler-Ross five-stage model of grief (Kübler-Ross 2005), which is illustrated in Figure 3.6.

It might be the case that many public sector managers are just moving into the bargaining and acceptance stage for change at a time when, as a consequence of the 2013 spending review, further financial austerity is upon them and fresh challenges and pressures are created.

A further aspect of organisational inertia is the strong resistance to change in public services caused by the large number of vested interests in maintaining the status quo. Such vested interests comprise a wide range of groups, including employees, trade unions, professional bodies, politicians, service users and charities. Some local authorities conduct consultation exercises whereby they assess the views of the public and service users about where the cuts in funding should fall. Almost universally the responses they receive are from those with a vested interest in the service, who oppose the proposed cuts, but hardly anyone suggests alternative courses of action.

Then there is the impact of political actions and political leadership. As will be discussed later, in some areas politicians at the local level have provided clear political action and leadership but this is not always the case and political direction is lacking in

Figure 3.6: Five stages of grief



Source: Kubler Ross (2005).

some areas. Nonetheless, it is at the national level that political direction is more lacking. While national politicians promulgate the overall message of austerity at a macro-level they often shy away from endorsing proposed changes to services at a micro-level and even when changes are proposed they may not be sustained in the face of public criticism. The government's 2012 budget contained a number of measures that were subsequently reversed, which encourages those campaigning against any particular proposal to believe that if the protest is sufficiently vociferous the government may back down. Also, there are several examples (from both the coalition political parties) of serving government ministers' publicly opposing service cuts in their constituency even though this is the policy of the government of which they are a member. All this tends to harden resistance to change.

## **FUTURE PROSPECTS AND FUNDAMENTAL QUESTIONS**

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Arguably, much evidence available (eg Prowle and Latham 2012) suggests there will be no immediate return to 'normal' rates of economic growth of 2.5–3% a year, some recent economic indicators have generated claims that the UK economy is showing improvements in performance, but it is far too early to predict that it will shortly return to 'normal' levels of economic growth. There are inhibiting factors of very high levels of public and private debt, and the economic situation in the Eurozone, which impact greatly on the UK economy.

This situation probably implies an end to the upward march of growth in public spending as illustrated in Figure 2.4. It also implies huge challenges for public

services and it may be that this situation should be seen as a watershed in the UK's social and economic history and not a temporary blip in the upward march of economic growth and public spending. This, in turn, requires consideration of a number of fundamental questions.

- What are the role and limits of the state in the provision of public services?
- What are individual and collective responsibilities in relation to public services?
- What are the relative priorities for public service provision?
- In the longer term, how should public services be paid for, including the balance between tax revenues, charges, insurance schemes and so on?
- What is the balance between the use of incentives and greater authoritarianism in public policy?
- How should the public sector be organised and governed?
- What should be the role of the private sector in future public service provision?
- What should be the role of the public sector in the UK economy?

It is in the light of this scenario that the main themes of this report will be discussed.

## 4. Main themes of the research

This chapter outlines the nature and importance of some key themes addressed in the research, which underpin the findings discussed later in this report.

### THE IMPORTANCE OF STRATEGIC APPROACHES

The term strategy is often loosely used in both public and private sector organisations. Many definitions of strategy abound, such as: ‘the long term direction of an organisation’ or ‘the determination of the long-run goals and objectives of an enterprise and the adoption of courses of action and the allocation of resource necessary for carrying out these goals’.

There are, however, four key points to be highlighted in most definitions.

#### Longer-term

The term ‘strategy’ generally implies a longer-term timescale (perhaps 5–20 years) and thus the strategic plan of the organisation is a longer-term plan.

#### Environmental and resources

The strategy should be based upon a thorough understanding of the organisation’s external environment and the structure of all the types of resource available to it over the planning period.

#### Vision and objectives based

Given the longer-term timescale implied in the term ‘strategy’ it seems very likely that the organisation involved will look different at the end of the strategic period than it did at the beginning. Consequently, we expect an effective strategy to provide some sort of vision about what the organisation will look like at the end of the strategic period compared with the beginning. Linked to this will be the identification of some strategic objectives (which

might be SMART in nature: **s**pecific, **m**easurable, **a**ttainable, **r**elevant and **t**ime-bound) to facilitate and underpin the achievement of the vision.

#### Necessitates organisational change

The implementation of most strategies requires organisational change, which is often significant and disruptive. The implementation of strategic change is often quite painful and can involve a number of issues such as reorganisations, job losses, changes in working practices, and new technologies. This process of change, which can have huge financial implications, needs to be effectively managed in order to implement the strategy.

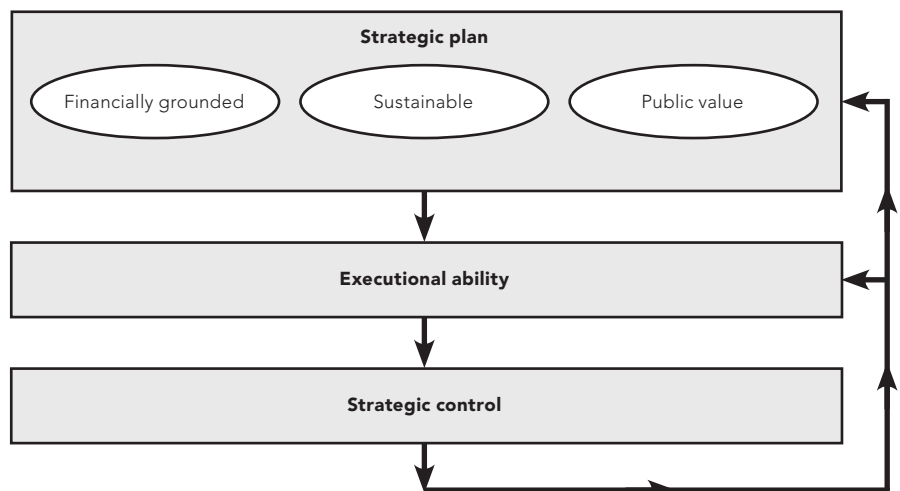
In considering what sorts of strategies public authorities should be pursuing in a time of austerity, and in facing the other challenges referred to above, the research identified five key themes that analysts suggest are vital aspects of such strategies. These can be thought of as an emerging model for effective strategy, which is illustrated in Figure 4.1.

The terms used in Figure 4.1 can be expanded as follows.

#### Financially grounded

The overall strategy of the organisation should be supported by, and consistent, with a suitable financial strategy. This should involve the preparation of robust, multi-year projections of the income, expenditure and capital streams associated with the strategy, which, in turn, would be linked to reasonable projections of likely financial resources available in future years. These financial forecasts should have been subject to a risk and sensitivity analysis, the profile of risk ascertained and the implications if risks materialise considered. There should also be broad agreement among stakeholders (eg the political leadership, board, managers) that the financial strategy on which the corporate strategy is based is a reasonable one. Finally, the published strategy of the organisation should incorporate its financial strategy and financial forecasts together with the key assumptions made and risk factors identified.

Figure 4.1: A model for effective strategy





### **Sustainable**

There are many definitions of what is meant by organisational sustainability and often these refer to specific aspects such as environmental sustainability. Two (similar) definitions that seem to be of relevance to public authorities in a time of austerity are:

- the ability to achieve goals and objectives, and increase long-term stakeholder value by integrating economic, environmental and social opportunities
- meeting present generational needs in a way that is economically viable, environmentally sound and socially equitable, but will also allow future generations to do the same.

Issues that seem to resonate with both these definitions of sustainability include an emphasis on: stakeholder value, longer-term plans, and the impacts on future generations.

### **Maximising public value**

It has been suggested that the fundamental aim of strategic financial management in the public sector is to optimise the supply of public services for the resources available, and in so doing create what Mark Moore has identified as strategic public value (Moore 1995).

Public value has at times been seen as the equivalent of shareholder value in public management and hence maximising public value is similar to the desire to maximise shareholder value in the private sector. Some will argue that even in the private sector the concept of creating public value (as opposed to just shareholder value) is slowly becoming embedded and thus there will in future be a greater alignment between public and private sectors.

Public value concepts have fast become an established (if as yet minority) approach to assessing the success (or otherwise) of public services and organisations in the UK, Australia and some other countries. A wide variety of organisations, from the BBC to the Scottish government, including police forces, local authorities, and public sports and arts organisations, have adopted some variant of the public value approach. This approach underpinned attempts in the UK, between 1998 and 2010, to tackle the so-called 'wicked' issues. Multi-agency collaborative strategies, structures and plans were operationalised and fulfilled by Local Strategic Partnerships through Local Area Agreements, by Crime and Disorder Reduction Partnerships through Crime and Disorder Strategies, and by the former Primary Care Trusts in the NHS.

Public authorities seeking to embed public value, as a principle, need to create a corporate culture in which the pursuit of public value by employees is rewarded, just as pursuing shareholder value is rewarded in private corporations. Such a culture is designed to encourage public managers to think about what is most valuable in the services that they run, and to consider how effective management can make the outcomes of these services the best that they can be for their communities. In doing this they sometimes need to recognise that public value may best be maximised by joint planning and working with other public authorities, rather than working unilaterally. Thus the importance of multi-agency planning and working is often a key component of the public value approach, as is the focus on outcomes for individuals and communities.

While public value could be increased by operational changes such as altering

the timing of services or the individuals involved in providing that service, it is more likely that its greatest impact lies in recognising that public value could best be maximised through major strategic changes in the pattern of service provision across the public sector. Thus public value can also be seen as a measure of the effectiveness of strategic management and strategic financial leadership (SFL).

Nonetheless, there are considerable difficulties that inhibit the development of public value approaches in the UK and there are many services and times when its application is demonstrably inappropriate and where traditional notions of the 'public interest' or the application of principal-agent theory is more appropriate. There are also many functions within public services that are provided on a clearly commercial or profit basis. As already mentioned, it is vital that public sector organisations recognise the limits of the use of the concept of public value and where and when to apply its techniques and approaches.

Although the current coalition government clearly favours a greater role for market solutions in its public sector reforms (Cabinet Office 2011), the establishment of Health and Wellbeing Boards to oversee local public health under the 2012 Health and Social Care Act demonstrates the continuing usefulness of the concept of public value to public service providers. Whereas in the UK the coalition government has attempted to reverse its influence in the reconfiguration of service provision, across Europe, Australia, New Zealand and further afield governments continue to appreciate where and when to embrace the concept of public value and how to operationalise its use.



## EXECUTIONAL ABILITY

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Developing an effective strategy is a major task, while implementing that strategy is perhaps even more difficult. Even with a superb strategic vision and the formulation of a robust strategy, the best-laid plans can go astray for several reasons, some of which are outlined below.

### Lack of clear responsibility

In strategy, and many other areas of life, nothing happens when no one is responsible. This is as much a failure of strategic leadership as it is a disconnection between strategy and implementation. Problems with lack of clear responsibility arise particularly in hierarchical bureaucracies such as public authorities.

### Overreach

Articulating ambitious goals and clear objectives in the organisational strategy will be ineffective if the organisation does not have the capacity and/or capabilities (human, physical, financial, political, etc) to achieve them. One common failing here is the underestimation of the amount of managerial input needed to effect a particular change.

### Communication and coordination

A lack of these can doom the execution of a well-crafted strategy. Even with plans that are clearly articulated, constant communication is critical, especially if the plans involve many participants and dynamic elements.

### Poor intelligence and information

A robust quality-assured evidential base is essential for good strategy making and for its successful implementation. Much of what is wrong with existing strategies is based on unclear objectives, sabotaged by loss of institutional control,

and supported by poor intelligence and information about what is actually happening on the ground, both within and outside the organisation. Also linked to this is a failure to undertake good future-based forecasting.

### Organisational inertia

This was discussed in Chapter 3 and is a major barrier to successful strategy implementation. Given the investment that goes into the adoption and implementation of a far-reaching strategy, dealing with such inertia is a key factor.

## STRATEGIC CONTROL

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Strategic control processes allow managers to evaluate the organisation's strategic progress from a critical, long-term perspective. Such a control framework focuses on the dual questions of whether the strategy is being implemented as planned and whether the results produced by the strategy are those intended. Thus, strategic control goes well beyond purely financial measures. Effective strategic control can be considered as four elements: premise control, implementation control, strategic surveillance and special alert control.

### Premise control

Every strategy is based on certain planning premises, assumptions or predictions. Premise control is designed to check methodically and constantly whether the premises on which a strategy is based are still valid. If it is discovered that an important premise is no longer valid, the strategy will have to be changed.

### Implementation control

Implementing a strategy takes place as a series of steps, activities, investments and acts that occur over a lengthy

period. Implementation control is the type of strategic control that must be carried out as events unfold and such control needs to be properly resourced to be effective. There are two types of implementation controls: strategic thrusts or projects and milestone reviews. Strategic thrusts provide information that helps determine whether the overall strategy is proceeding as planned while milestone reviews monitor the progress of the strategy at various intervals or 'milestones'.

### Strategic surveillance

This is designed to observe a wide range of events within and outside the organisation that are likely to affect the progress of the organisation's strategy. It is based on the idea that you can uncover important yet unanticipated information by monitoring multiple information sources. Horizon scanning or future proofing are essential parts of strategic surveillance.

### Special alert control

This is the rigorous and rapid reassessment of an organisation's strategy in the light of an immediate, unforeseen event. Such an event will trigger an immediate and intense reassessment of the strategy.

## STRATEGIC LEADERSHIP

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Leadership is often distinguished from management in organisations. Kotter (1988) strongly defends the view that management and leadership are different functions and that managers do not undertake leadership functions. He argues instead that managers are responsible for ensuring order and efficiency in the organisation while leaders are responsible for having a vision of the future and then forcing the organisation to adapt to that vision.

Hence, on the basis of Kotter's view, the term 'leadership' is often used to mean 'strategic leadership', which can be regarded as:

- the establishment of a vision for an organisation and communication of that vision to stakeholders (Kotter 1988), and
- the process of social influence in which one person can enlist the aid and support of others in the accomplishment of a common task (Chemers 1997).

Traditionally, research on leadership focused on the traits of leaders but more recent research suggests that effective leadership is strongly contingent on the situation and an effective leader in one situation might not be so effective in a different situation. This is important because, as already argued, the UK public sector faces a historical turning point in that annual growth in resources (to which managers and leaders have been accustomed in the past) is unlikely to take place for the foreseeable future.

Other scholars emphasise that there are styles of leadership. Lewin et al. (1939) identify three leadership styles and the situations in which each style works best:

- the authoritarian leadership style, for example, is approved in periods of crisis but fails to win the 'hearts and minds' of followers in day-to-day management
- the democratic leadership style is more effective in situations that require consensus building, and
- the laissez-faire leadership style is appreciated for the degree of freedom it provides, but as the

leaders do not 'take charge' they can be perceived as failing during protracted or thorny organisational problems.

While individuals may often display a mix of such styles, it is important to give consideration as to what is the most appropriate style in the current economic and financial climate, and this may be very different from styles needed in the past. It is not simply a case of a leader's adoption of a different style to meet the challenges of a new environment in which precedent cannot always be followed. Modern approaches to strategic management emphasise the need for a strategic leader to adopt a series of different styles depending on the individual issues that arise. A leader therefore needs to be capable of a strategic portfolio of styles, and this can sometimes mean that an individual leader may be forced to adopt a particular style that, while suitable for the circumstances, is beyond his or her 'comfort zone'. The project team responsible for this research were aware of a number of metrics that are available for measuring leadership styles, but recognised that it was beyond the scope of this individual project to attempt to cross-reference the strength of any particular organisation and its strategy to the leadership style of the principal actors.

Another issue concerns the focus of leadership in organisations. Many commentators see leadership as very much the province of the chief executive, who is often a charismatic figure. On the other hand, authors such as Jim Collins (2001) believe it is important to focus on the leadership capabilities of the whole management team. In this context, leadership would therefore almost certainly be an attribute desirable in the finance

director of the organisation as well as other executives. Within the public sector the co-existence of both political and managerial structures may make it difficult to discern the centre of leadership. This may be unclear in both central government and local authorities but is even more opaque when central government services are provided through local agencies, where political oversight is more distant. This also complicated by the increasing tendency within political leaderships to act increasingly in a more managerial role, becoming, so to speak, 'super managers', a road that elected mayors and the newly elected police and crime commissioners may be tempted to follow. This can lead to a lack of leadership focus.

A final issue concerns settings and, in particular, the role and importance of leadership in multi-agency settings that are complex but vitally important to public service provision. Liddle explores the role of leadership within a complex multi-agency context, often fraught with 'ill-defined, networked, collaborative domains with imprecise boundaries and role ambiguity' (Liddle 2010) In order to add public value, Liddle advocates that leaders must understand the context (political and wider environment) and the processes necessary to bring about strategic change, as well as the content of how change can be instigated. To lead effectively they need to predict how multitudes of stakeholders will be affected, or can affect decision-making. They must develop futuristic, imaginative and innovative scenarios, and adapt and harmonise a myriad of processes, structures, institutions, partnerships and agency within turbulent, dynamic, global, national and local regulatory frameworks.

In summary, some key issues to consider in relation to leadership are:

- situational factors
- management styles
- focus of leadership
- multi-agency settings.

All these are relevant factors for public service leadership in a time of austerity.

### STRATEGIC FINANCIAL LEADERSHIP (SFL)

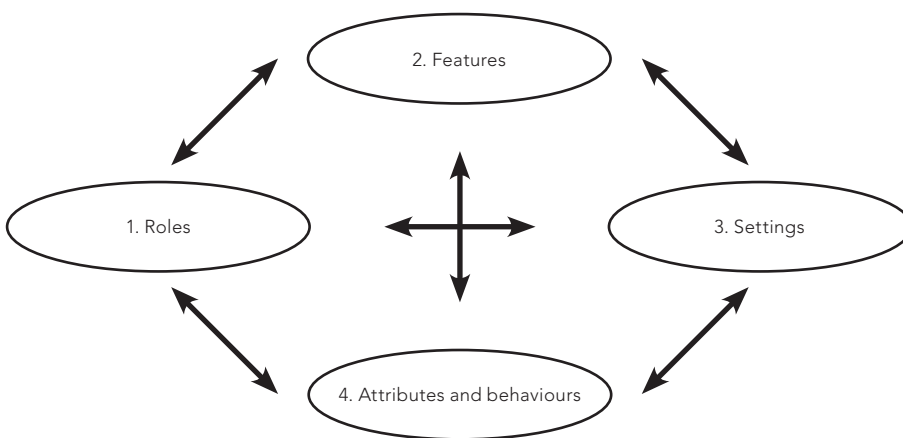
Strategic financial leadership is the core interest of this research and it is important to have some understanding of what is meant here by this term. Clearly, as its name suggests, this term is concerned with leadership and the financial aspects of strategy within an organisation, but that is not a sufficiently precise definition to enable identification of SFL and to assess its performance and applicability. Hence an overarching model for SFL has been developed during this project, which is shown in Figure 4.2; the terms used in this are discussed below. There are overlaps between the various themes discussed and effective SFL can be seen as something of an amalgam of them all.

### ROLES

At the outset, it must be stated that the key roles of SFL are to undertake specific tasks with particular (but not exclusive) emphasis on the following.

- Strategy development, ie to develop a strategy that:
  - is financially grounded with regard to resources and the organisational environment
  - can provide sustainable public services in a time of austerity
  - maximises public value from the use of public funds, and
  - optimises the creation of public value across collaboration.
- Communication and engagement, ie to communicate the strategy (and its financial aspects) to a wide range of (internal and external) stakeholders in order to build commitment to that strategy.
- Execution, ie to facilitate the execution of the strategy so as to achieve strategic objectives, within budget and according to timescales
- Control, ie to develop and use suitable control systems to monitor the achievement of strategic objectives (including strategic financial objectives) and to identify and implement remedial action where required.

Figure 4.2: A model of strategic financial leadership



In practice, the roles of strategic finance managers everywhere are changing. In the business world a transformation is taking place in the finance function along the lines shown in Figure 4.3.

This shows that, in the future, the roles and focus of finance managers will increasingly be concerned with the provision of analytical services to the organisation. Transactional services will have a reduced emphasis as a consequence of outsourcing and/or the use of shared services facilities.

The development, execution and monitoring of sustainable strategies in public authorities will require a wide range of complex and sophisticated financial analyses. Such a transformation has been taking place in the private sector (CIMA 2011) and can also be expected in the roles of public sector finance managers. This implies an increased use and range of competences in analytical areas such as:

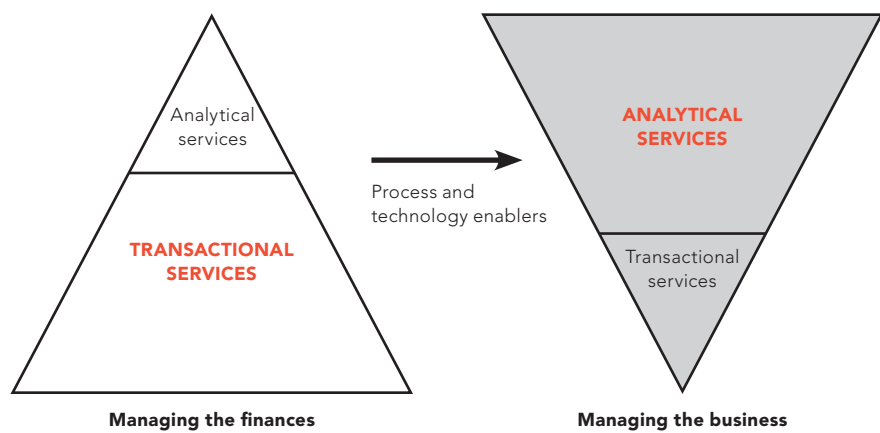
- cost and cost driver analysis
- performance analysis and reporting
- budget setting
- forecasting
- decision-support modelling.

## FEATURES

Strategic financial leadership in a time of austerity should display the following features, which must be kept in mind when considering this study. These are that SFL:

- is not necessarily just the province of finance professionals, since financial leadership will be given by chief executives or other non-finance specialists; indeed, where the

**Figure 4.3: Transforming the finance function**



professional finance department is weak, it may be incumbent on others to do this

- must recognise the nature of financial and economic austerity described above and must be active in that context (ie it is not a context in which 'things will be OK in a year or so')
- must focus on the need to achieve longer-term sustainability in the provision of public services and to maximise public value from the use of public resources
- must recognise the need for collective functioning of several public sector organisations in creating public value

- must recognise that strategic finance managers must become actively involved in finding ways around any barriers to achieving the above aims, and/or work to have them removed, either as individuals or through professional bodies and lobbyists; it should not be seen as the role of professional bodies to support or leave un-criticised the policies and practices of the government of the day or of opposition parties
- must recognise that these features can be demonstrated and applied at various levels and settings in the public sector.

## SETTINGS

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It should be clear from the above that the performance of strategic financial leadership should not be seen as a narrow function undertaken just within the finance department but one which can, and should, be undertaken and displayed in various different settings including:

- within the finance department itself
- within and throughout the individual public sector organisation
- at the corporate/board level
- in the public domain with, for example, the general public and the media
- in partnership working with other public authorities.

## ATTRIBUTES AND BEHAVIOURS

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SFL must involve finance managers in taking ownership of and demonstrating a number of attributes and behaviours, including the following.

- Innovation – finance managers must create and present innovative approaches to public service provision, incorporating the financial consequences.
- Strategic vision – finance managers must create a clear and achievable vision for the longer-term future of public services, grounded in realistic resource limits and incorporating innovative approaches.
- Communication – finance managers must demonstrate effective communication skills to convey that vision to a wide range of

stakeholders, including the means by which the strategic vision can be achieved.

- Action – finance managers must be proactive in promoting the strategic vision for public services that has been developed and in identifying strategic actions designed to achieve that vision.
- Strategy vision and development – finance managers need the ability to develop detailed strategic plans derived from the vision, which are grounded in realistic resource limits.
- Implementation – finance managers must recognise what is needed for effective implementation of the strategic vision and plan, including realistic assessments of the costs of implementation and the resources required.
- Commitment – finance managers must demonstrate firm commitment to the achievement of the vision and the strategic objectives.
- Objectives – finance managers need to recognise the need to establish clear (SMART) strategic objectives at the outset and set up systems to monitor progress against those objectives from an early stage.
- Monitoring – finance managers must recognise the need to establish workable arrangements to monitor progress against the strategy and to take any remedial action required.

Words are not enough – what need to be considered are the significant organisational and cultural changes that might be needed to achieve the objectives: not just narrative but strong discourse that drives the organisation. It

is not just senior finance managers who need to demonstrate these attributes – all strategic managers should be able to do this. Finance managers need to be in a position to support the strategic process, especially in relation to financial issues.

## SPECIFIC APPLICATIONS OF STRATEGIC FINANCIAL LEADERSHIP

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There are a number of distinct (but overlapping) situations where the application of strategic financial management and strategic financial leadership in relation to public services is imperative. The main ones are set out below.

### Financial evaluation of public policy in central government

Public policy for many public services (eg law and order) is formulated on a UK basis by the UK government. However, since the relatively recent advent of devolution, other public policies (eg health) are formulated for England by the UK government but for Scotland, Wales and Northern Ireland by the devolved administrations.

Traditionally, the UK has highly centralised governance arrangements, and policymaking and funding decisions about public service provision were strongly centralised. This strong element of centralised policy making seems to have also been adopted by the devolved administrations.

Policy and financial decisions by central government have significant implications for public authorities across the country. Unfortunately, central government departments in the UK do not have a good track record in this area. Several examples can be quoted of public policies that have been ineffective or have run vastly over

budget. Moreover, in 2010 the Institute for Government conducted a poll (IfG 2010) of political science academics, asking them to identify what they saw as the most successful public policies over the last 30 years. The results from the 150 respondents showed little consensus, with the most successful public policy (the minimum wage) only getting 24 (out of 150) first-preference votes. Other highly ranked public policies were seen as: privatisation, 'Sure Start' and devolution, a situation that would probably cause many eyebrows to be raised outside Whitehall. There were hardly any votes for successful policies in the fields of education, defence or transport, which are key public service areas.

Moreover, there have been serious concerns in the past about the quality of financial estimates on which policy decisions are made. In 2004, the new general medical services contract was introduced; this was designed to create substantial changes to the way in which general medical practitioners were remunerated. It was always expected that there would be large costs associated with the new contract but in the end, between 2003 and 2006, the Department of Health spent £1.76bn (9.4%) more than it budgeted for (NAO 2008). Then there were the London Olympics. The original budgeted cost submitted to the International Olympic Association was £2.4bn but that figure rose quickly (in several stages) to an 'absolute' limit of £9.3bn. In fact, reports have suggested that the real total cost amounted to £12bn, with the additional £2.7bn being hidden in obscure documents and reports. Very recently Peter Mandelson, the former Labour cabinet minister, disclosed that in 2010, when the then Labour government decided to back the High Speed Train Project (HS2), it did so on the basis of what were termed the 'best estimates'

of what it would involve. It has emerged that these estimates were entirely speculative, and the original (speculative) estimate of £30bn has now risen to £42bn. These examples seem to indicate a somewhat cavalier approach to the use of public funds that would not be tolerated in other parts of the public sector.

Hence a key issue of SFL must be the way in which it is practised in central government departments. Key issues concern the level and type of financial input into public policymaking, the way in which financial projections relating to policy options are prepared and the extent and quality of risk analysis undertaken. Unfortunately, these matters are generally shrouded in mystery as a consequence of the prevailing lack of transparency in Whitehall.

### **Strategic development of an individual public authority**

Irrespective of, and in conjunction with, any issues of multi-agency strategy, each public sector organisation will be responsible for the development of its own strategy for a period of years ahead. This will require effective SFL within the organisation in order to achieve sustainability and maximise public value from the resources available over the strategic period. The nature of financial and economic austerity means that this task must focus on the development of a strategy that would (if possible) achieve these results with no increase in the level of resources (or even with substantially fewer resources).

### **Strategic service reconfiguration in public services**

In many parts of the public sector, strategic change often involves major reconfiguration of services and of the organisations that commission and

provide those services. Some actual or potential examples of this might include:

- merger of district council and county council functions and abolition of district councils, removing one of the tiers in multi-tier local government
- a more substantial reorganisation into a unitary structure, by imposition or by voluntary amalgamations
- reconfiguration of health services, including the potential closure of some units and the changing function of other units
- merger of FE colleges and universities into a small number of units with appropriate reconfiguration of activities
- merger of fire and rescue services and/or authorities,
- reconfiguration and/or merger of government agencies.

Each of these involves several public sector organisations working together towards a common end, even though there may not always be a consensus as to what that end should be.

The consequences of such reconfigurations are complex and sizable and there is not always a clear starting point or a commonly agreed end point (this comment applies to both financial and other aspects of the proposed change). Moreover, the managerial responsibility for the various aspects of the whole reconfiguration process is not always transparent. Not surprisingly it is not uncommon for financial and non-financial failures to result from such reconfigurations.

The likelihood of there being a number of such reconfigurations in the future means that this is a key area for demonstrating strategic financial leadership.

### **Inter-organisational strategic development**

Different public organisations provide different public services but the strong interrelationships and dependencies between these services are well known. For many years it has been a major government priority to improve inter-organisational working in the public sector for a variety of reasons, including better service integration, avoidance of duplication, and improved efficiency.

Despite this, good examples of effective inter-organisational working between public agencies are often hard to come by, although there are some good examples of health partnerships, local enterprise partnerships (LEPs), and children's boards. The 'total place' pilots, for example, in Cumbria also indicated good inter-organisational working. Nonetheless, the real issue here is that this is not sufficiently consistent across the country and between agencies to be relied on for strategic development and this must be due, at least in part, to the strong barriers to such working, including competing strategic objectives of the agencies, non-transferability of funding, lack of commitment and lack of leadership. Thus a key component of effective SFL must be the way in which it has managed in part to overcome these barriers and improved the effectiveness of inter-organisational working.



## 5. Description of the research

### UNDERLYING RATIONALE

The underlying rationale for this research is based on an observation that austerity is seen, largely, as a political issue. We keep looking for political solutions to the problem of public services in austerity, whether through cuts in spending, increased charges, raising council tax or otherwise.

This research focused instead on how public authorities are applying managerial approaches and solutions to the challenges of austerity and, in particular, the role that the public sector finance function can play in this process. In particular the research focused on how finance professionals in the public sector can contribute (and are contributing) to leading this process.

### RESEARCH QUESTIONS

Four research questions were posed in this research.

1. What are the key challenges being faced by public authorities?
2. How are public authorities responding to the challenge of financial austerity?
3. How might effective strategic financial leadership assist in dealing with the challenges presented by financial austerity?
4. Is strategic financial leadership being applied effectively at the present time?

### RESEARCH APPROACH

The research has been conducted in accordance with the sequence shown in Table 5.1.

**Table 5.1: Research approach**

No	Stage
1	Literature review
2	Development of conceptual framework
3	Structured interviews at ten case study organisations
4	Transcription of interviews
5	Coding and analysis of findings
6	Report

It will be noted that the thrust of this research is the use of case studies of public authorities. In total ten case studies were developed as shown in Table 5.2. The primary method of research was interviews with key personnel (eg chief executive, finance director, other directors) within the case study organisations; the examination of documents; and limited observational evidence from research visits to the sites. The interviews were undertaken in nearly every case by two members of the research team, to assist analysis and reduce interviewer bias. The analysis of interviews employed a coding methodology based upon the initial literature review for the project. The robustness of the findings has been tested via further interviews, after the initial round, with interested parties and team meetings with a wider expert panel established for the project. The team members who conducted the interviews combine strong academic credentials with senior management experience at the highest levels in

various public authorities and public companies, and have held positions of esteem in a number of professional organisations. Thus they constitute a very informed set of interviewers.

**Table 5.2: Case studies**

Sector	Organisations
Local government	Five case studies
Further Education colleges	Two case studies
NHS	Three case studies (Two NHS Trusts plus one area team)

It will be noted that there were no case studies in central government. It was the original intention to do this but, despite strenuous efforts, it proved impossible to get any degree of engagement from central government departments. Consequently, while in the findings section there are comments about practices in central government, the researchers were reliant on indirect commentaries from various informed parties such as think tanks and retired employees rather than direct research.

The use of case studies means that there is absolutely no attempt here to provide a generalisable analysis of the current situation of strategic financial leadership in the public sector. Instead, the emphasis has been on identifying and describing good practices in parts of the public sector (as well as the private and third sectors) that should be easily transferrable and which describe situations and experiences where public authorities are adopting and applying



approaches to SFL. Some of the case study themes this research has tried to tease out include:

- how the individuals see the current circumstances facing their organisation/sector nationally over the longer term: 5 to 10 years
- what they consider to be the impact of those changes on their own organisation, and the range of possible options open to them
- the strategy they think is feasible for their organisation to use in addressing the issues that they face, and their assessment the risks and opportunities that such a strategy might face and might present
- how the individuals see the current circumstances facing their geographic area over the medium to long term and the probable implications for multi-agency working at the strategic level
- the kind of leadership that they think is necessary to get the organisation and its community to implement the strategic approach and whether they think they have the personal and organisational capacity to deliver that leadership
- what they see as the role(s) that are or should be pursued by the finance function(s) over that period and whether they believe the finance function has the capabilities to fulfil those roles effectively.

## 6. Findings of research

The findings of this research have been structured under six main headings:

1. Challenges
2. Vision and strategy
3. Strategic leadership
4. Strategic role of finance
5. Comparisons with best practices in the private sector
6. Central government.

The first five sections relate to the sectors where the case study research was carried out (ie local government, the NHS, FE colleges). The sixth section relates specifically to central government, which is a sector where, as already explained, the researchers were unable to get any direct engagement and so have relied on comments and opinion from informed persons.

### CHALLENGES

This section summarises what are identified by the case study organisations as the key challenges facing them at the present time in dealing with the pressures of austerity. Three topics were frequently mentioned: the ageing population, the need for a robust evidential base, and the lack of political leadership.

#### Population ageing

This has already been discussed at some length in earlier chapters and it will suffice to state that it was an issue frequently raised by many interviewees, particularly those in the health and social care sectors. Frequent reference was made to topics such as the so-called 'Graph of Doom', which is shown in Figure 6.1.

This diagram suggests that without serious changes in policy and radical actions, expenditure on social care in local authorities will, in the relatively near future, consume (and later exceed) the total budget of the authority, leaving nothing for other services. Thus the challenges for public authorities are to design and provide services to a rising number of elderly people in a time of stagnant or reducing resources.

#### Lack of a robust evidential base

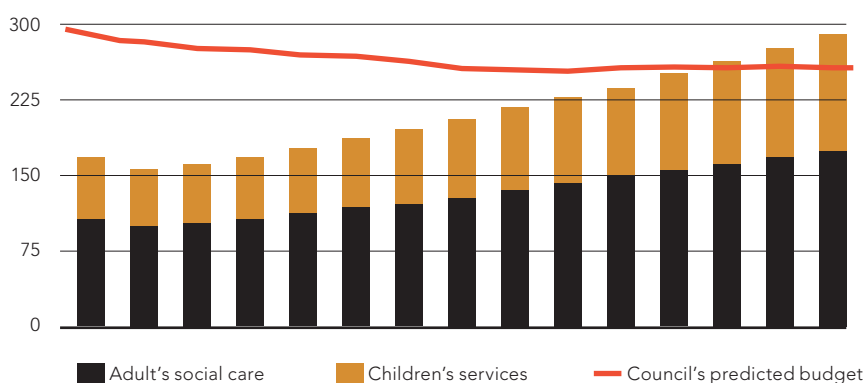
There was a basic lack of information on which to base strategic decisions. This included amongst other things

- a lack of information about the cost structures of current services and the relevant cost drivers
- a lack of information about comparative performance (including costs) of other comparable service-provider organisations
- a lack of reliable information about the effectiveness of different models of service provision.

#### Lack of political leadership

In one case study organisation, a local authority, an incoming political administration set a clear political direction for the organisation, for dealing with austerity. While this direction was extremely controversial and was not aligned with the views of senior managers, there was an acceptance that the clear direction given assisted in dealing effectively with the financial challenges of austerity. Similarly, in some other case study organisations the elected members or the board had also provided clear 'political' direction at the local level, which was helpful, but where such direction was absent or vague this complicated the process of meeting the challenges of austerity. In general terms there was a greater degree of criticism about the lack of direction and guidance given by national government about priorities in dealing with austerity even among those who accepted that such austerity was a necessary evil.

Figure 6.1: Graph of Doom



Source: INLOGOV blog (2012).

## VISION AND STRATEGY

One of the key points to emphasise at the beginning of this section is that for a period up to and including 2014/15, the case study organisations anticipate, with some degree of certainty, that their required budget reductions will largely be achieved. This is the case in all the sectors reviewed for this study. This is an important finding and various means have been used to achieve this result, including considerable reductions in support services, sales of fixed assets, raising of the thresholds for entitlements and outsourcing of services, but there has also been a strong element of front-line service protection, efficiency improvements, and so on. Nonetheless, all the personnel interviewed stated that there were limits to how much further these approaches could be used in the future.

In the NHS, there was a quite strongly held view that the organisation is maintaining services quite well in the first stage of austerity. With very small growth in real terms in the NHS each year, the task has been to contain the growth in demand by focusing on issues such as unwarranted variation in care. This has led to productivity gains in length of stay, day case ratios, outpatient follow-up ratios, re-admission rates, use of diagnostic testing and prescribing, etc. The public sector pay freeze has also helped to contain costs. Sharing UK best practice and benchmarking and comparing similar organisations against one another have driven this approach. Nonetheless, there appears to be no quantified assessment as to how the NHS is performing against the £20bn austerity target referred to earlier or the balance between cash-releasing savings (which would probably be required for much of the investment in new services) and non-cash-releasing savings.

In spite of what has been achieved so far, it should not be assumed that this has been an easy task – this was emphatically emphasised as not being the case. Many thousands of jobs have been lost, services re-designed, consultation exercises undertaken and a huge amount of managerial time and effort has been needed to achieve this balanced financial position. As a consequence, some organisations that have implemented large-scale reductions have actually seen improvements in some of the measures of service quality and/or improvements in public satisfaction levels with services. This is often the result of improved communications with service users, and better management of expectations, and recognition by users that improved value for money has resulted.

One of the specific themes addressed in the study was that of service innovation, which is very topical in public services. Innovation can be defined as ‘the application of new solutions to meet new requirements and/or existing needs’. This would be accomplished through more effective products, processes, services, technologies, or ideas and the term ‘innovation’ can be considered as meaning something original and new that ‘breaks into’ the market or society. Many organisations will make changes in their approach to service provision for a variety of reasons, including cost improvement, but such changes are often marginal and cannot really be regarded as innovation. In reality, during the course of the study, the researchers did not discover a lot that could be regarded as true innovation although there were many adjustments to existing service provision. In the NHS there was some evidence of innovation savings (referenced on the websites of the innovation functions of the former

strategic health authorities (SHAs)), but these were small in scale. For example, in the East Midlands the total innovation savings/income generation amounted to £13m over a number of years compared with an annual budget of some £5bn. So although this is encouraging it is small compared with the total budget involved and in itself will make a limited contribution to the challenges of austerity in the NHS. In many ways this should not be surprising since the pace of imposition of austerity measures provides little time for the sort of innovative thinking required and the tendency for public authorities to be risk averse can inhibit true innovation.

In undertaking this task of dealing with the required funding reductions, the various organisations visited have used a number of managerial approaches that need to be highlighted and copied by other public authorities. These include the following measures.

They have used a multi-year strategy and budgeting approaches rather than the year-by-year approaches that have dominated in the past. In saying this one must recognise that most public authorities prepare ‘broad-brush’ multi-year financial projections for submission to central government departments or agencies. In practice, such projections are often of limited use and often just represent extrapolations of the past while having little in the way of underlying strategies. Given the nature of the strategic approaches needed to cope with austerity, such multi-year budgeting might be expected to be seen everywhere but many public authorities still do not do this. Moreover, one of the last Audit Commission studies (Audit Commission 2010) to look at the future planning arrangements of a sample of local authorities found that a significant

number were operating on too short a timescale to be able to factor in the extent of change that will be required.

They have promoted considerable changes in attitude to and engagement with financial issues among (non-financial) service managers and directors. This has led to a greater understanding of service costs and cost drivers among service managers and a greater willingness to identify changes to service provision that will reduce costs.

They have used formal 'challenge' rounds whereby service managers at several levels in the organisation are required to accept and respond to challenges to the way in which their services are provided and the associated cost levels.

Multi-agency working at a strategic as well as at an operational level was seen by many interviewees as an important goal for public authorities for a number of reasons, including better-coordinated services, better service outcomes, better use of financial and physical resources and improved public value. Even so, in practice, these public authorities had only limited engagement on coordinated strategies with other public authorities in their area. Although everyone interviewed acknowledged the importance of strategic working between multiple agencies, and undertook attempts to do something in this area, the general conclusion was that it is an area of activity that has become more 'difficult'. Comments were made that the time and effort that had to be put into such multi-agency working at a strategic level can be enormous even with regard to what should be fairly straightforward issues such as procurement or payroll development, let alone much more contentious areas such as front-line services. In the present environment,

managers did not believe they had the time and resources available to devote to such multi-agency working, given the uncertainty of the outcomes of the process. Multi-agency proposals are often beset with technical problems concerning legal and contractual issues and technology, and cultural issues are often the 'blockers' to success. Fear of the loss of organisational integrity, a feature of hierarchical bureaucracies, means that organisations will often tolerate a level of inefficiency in order to remain separate, and in joint projects will insist on local variations that fail to create public value.

Looking to the future, the government has recently made some small moves to enhance joint service provision between the NHS and local government. The £3.8bn health and social care fund that the chancellor has announced involves a transfer of funding from the NHS to local government to create a health and social care fund that the NHS and local authorities will work together to spend. This may force more alignment and could be a further move into this territory. On a bigger scale, proposals to transfer of the NHS commissioning function (and its £100bn budget) to local authorities might have a significant impact on joint commissioning but whether a future government would do this remains to be seen.

Chapter 4 identified five criteria by which the strategies of public authorities can be judged:

- financially grounded
- sustainable
- maximising public value
- executional ability, and
- strategic control.

As already indicated, the case study organisations had well established and multi-year financial plans and budgets that they were confident of achieving. Hence it seems that the strategies they were adopting were financially grounded, indeed they seemed predominantly financially led.

Nonetheless, with regard to some of the other criteria the situation is not so clear. As mentioned above, the under-development of multi-agency working seems to imply that public value cannot be being maximised. Furthermore, while the strategies that have been adopted might be seen as sustainable in the short term they cannot be sustainable in the longer term given the pressures of increasing demands and higher costs. The existing strategies are apparently being executed satisfactorily and there is at least some degree of strategic control in place.

Nonetheless, some strategies appear subject to the 'fallacy of composition'. Their success depends on their being able to fund cost reductions by getting others to take on service provision, failing to recognise that the individuals or organisations are often themselves seeking cost reductions, so that the required objective of low-cost service provision is frustrated.

Looking ahead, all the organisations visited had a widespread expectation of further austerity. Not only would this be the case for the year 2015/16 (outlined in the recent spending review) but also in subsequent years. None of the organisations anticipated any significant overall growth in resources for the foreseeable future (albeit there may be growth in some areas countered by reductions in other areas).

As already noted, the public authorities researched here had developed and

were implementing strategies that were likely to lead to a balanced financial position over the period of the 2010 spending review. Looking beyond this, however, the general conclusion of this research was that even though further austerity was expected the level of strategic thinking around this acknowledged next phase was quite underdeveloped at this stage. Most of the people interviewed were of the view that the sorts of actions that had been taken to deal with the first phase of austerity were unlikely to be capable of being repeated and/or extended and new approaches would be needed. Although many said they had some preliminary thoughts about the sorts of change that might be needed in the longer term there was little detailed analysis and certainly very few longer-term financial projections. Also, some of the strategic themes mentioned seemed to contain severe flaws and there seemed to be strong differences between senior managers as to the direction and vision that the organisation should have. In some cases strategic proposals seem to be disconnected from reality, in that senior managers would see significant threats to the future of the organisation but these threats were not addressed in the organisation's strategic response. Very often the desired outcome of the strategy was relatively clear, but there was no clear plan to get from A to B, and little contingency planning or risk assessment.

## STRATEGIC LEADERSHIP

Strategic leadership is a theme that has been endlessly discussed and emphasised with regard to the UK public sector, for perhaps several decades, but the degree of progress that has been achieved is debatable. As already discussed, the situation in which public authorities find themselves today is substantially different from that existing, say, five years ago. This case-study research identified a number of leadership themes that are an important consideration in the present environment.

As noted in Chapter 4, much modern scholarship about leadership emphasises its situational dimension. By that is meant that leadership approaches and leaders may need to be different in different situations. Clearly, the public sector is now in a vastly different situation than it has been in living memory. Hence leadership approaches and leaders in a period of austerity may well need to be different from those appropriate in a period of growth. The reality is that most senior managers in public authorities spent most of their careers in a period of growth and are used to leading their organisations towards new services, better quality, etc. They may not be comfortable or confident about leading their organisations in a time of austerity and this, in turn, may affect their leadership competences.

Linked to this, the extent of training and experience in strategic leadership that many senior managers in public authorities have undertaken is not clear. A large proportion of senior managers in public authorities come from strongly professional backgrounds (medicine, teaching, social care, engineering, finance, etc). In conducting this study,

the researchers noticed that some of these managers seemed to lack academic training for and/or practical experience of strategic leadership in any setting, let alone one of austerity. Leadership skills form part of most professional training, but are often not exercised early enough for the formal training to have effect. There is a more general assumption that people will gain leadership skills during the course of their career and that these are generic skills that can be applied to any circumstances. This may not be the case when circumstances change radically. The fallacy that all leadership skills are transferable was perhaps most notably demonstrated in the case of Robert McNamara, whose skills as CEO of Ford were seen to be lamentably lacking when it came to acting as the key political manager in the conduct of the Vietnam War.

Finally, this research emphasises the importance of multi-agency working in the maximisation of public value. As already noted, this seems to be a theme that, although recognised in importance, is not closely pursued in practice. As pointed out earlier, there is a need for leaders to have a greater understanding of the context (political and wider environment) and the processes necessary to bring about strategic change in an austerity setting. Although the interviewees suggested that the adversarial nature of the UK's political and legal systems, the short-term nature of public financial planning and the over-emphasis on revenue programmes at the expense of greater interest in capital projects may militate against large, long-term complex collaborative projects. This surely represents an inadequacy of leadership. Cynically and enthusiastically describing partnership working as the temporary suspension of mutual loathing in pursuit

of government funding is not an acceptable standard of discourse, attitude or behaviour from holders of public offices charged with protecting and promoting the public purse.

## **THE STRATEGIC ROLE OF FINANCE**

This is perhaps the key section of this report, which looks at the role that the finance function plays in responding to austerity and the degree of leadership that is being applied. The case study research yielded the following findings.

### **Locus of finance**

At the outset, in all the case study organisations visited, it was clear that the finance function is at the forefront of strategic planning and in many cases the strategy is largely finance led. The finance director (or equivalent) was a member of the senior management team. In these situations the finance function is trying to get the organisation more strategically focused (with varying degrees of success) at several levels in the organisation but this is sometimes hampered by the lack of strategic management skills among managers at all levels. As well as involvement in the development of strategy, the finance function may take the lead (or at least, be strongly involved) in the implementation of the strategy and in the monitoring of outcomes.

### **Organisation and resources**

One of the key dilemmas for a finance function is that the time available for dealing with strategic issues is constrained because of the pressures of operational finance issues such as payments, accounts maintenance, etc. Furthermore, the pressures for efficiency improvements from the finance functions themselves (traditionally seen as back office functions) have increased subsequently as a consequence of austerity.

Consequently, there is a perceived view that financial capacity and capability are currently being eroded at a time when the task of dealing with austerity requires financial management to be strong and capable. To deal with this, a number of the case study organisations researched have created small teams with concentrations of strategic financial expertise, which are separated, in some way, from operational aspects of finance. Indeed, many of the operational duties of finance may have been outsourced or converted to a shared service arrangement. The finance director (or equivalent) would be a member of this strategic team but would also retain overall responsibility for the operational accounting activities, which would be delegated, on a day-to-day basis, to another manager.

### **Approach**

There was a strongly stated opinion among the case study organisations that for the finance function to be effective in providing strategic financial leadership it is essential for leadership to be given by both the finance director and the chief executive. Luke-warm support from either will probably have a dampening effect. Furthermore, it was also seen as important that strategic finance managers adopt a dynamic rather than a static/passive approach towards financial leadership. This will involve less time at their desks and more time being out and about in the organisation and networking with managers from their own organisation and other related public authorities. In this mode of working it will be important that they communicate to service managers the true nature of the challenges being faced and the nature of the organisation's strategic responses to those challenges.

### **Relationships**

A key theme that emerged from the research is the importance of the relationship between the strategic finance manager and the non-financial service manager. In the case study organisations, finance managers have developed a good understanding of the nature of the services/businesses involved and are in a position to provide strong challenges to existing assumptions and costs of current service provision in the organisation. Furthermore, strategic finance managers are developing more effective working relationships with service managers following what has been termed a business partnering model rather than a traditional accounting and financial control model. This is based on a finance transformation that has been recognised for over a decade in the private sector but now needs to evolve in the public sector. This is a journey towards a situation where the efficiency of operational finance activities will have been maximised through shared services, outsourcing or internal efficiency and the strategic role of the finance function will have become dominant. Much stronger roles are seen for strategic finance managers in relation to matters such as cost analysis, performance analysis, and financial forecasting, rather than just traditional financial reporting. This change was highlighted earlier in figure 4.3. In this way, finance is seen less as a necessary overhead and more as an important management discipline that promotes added value from scarce resources. The importance of such a change to finance managers and their employing authorities cannot be over-emphasised.

### **Environment**

As already stated, during the research it was notable that the organisations had deliberately focused on improving the

financial skills and literacy of their non-financial service managers. While this is often said to have been of importance in many public authorities, in others it has been almost ignored. Historically service managers have often been allowed to retain their stated view that 'finance was nothing to do with them' since they were service professionals. In the case study organisations, service managers had developed a better understanding of the costs of their service activities and the drivers of those costs and were in a better position to identify changes to strategies and working practices and to assess both the financial and non-financial implications. These perceived changes in attitudes and skills have been achieved by a combination of formal methods (eg training courses on finance for non-financial managers) and informal methods such as effective liaison between finance and non-financial managers, which forms an integral part of the business partnering model referred to above. It is also important that finance directors recognise that they have the key role in improving financial literacy and the financial skills base throughout their organisation.

### **Financial techniques**

In many of the case study organisations there had clearly been a strong emphasis on the development of financial techniques. Improvements in costing systems and costing methods are one example of this, with FE colleges developing course/programme costing systems to gauge the profitability of their activities and NHS Trusts developing patient-level information and costing systems (PLICS) in order to understand more fully the costs of their clinical activities and how changes might be made. Other examples would be improvements in multi-year forecasting and budgeting

systems (and associated financial modelling) as an aid to developing and analysing longer-term strategies. This is not universal and some public authorities see such approaches as 'too academic' or 'too complicated for us' but this is a view that must be challenged. The pressures of austerity place a premium on high-quality financial management and leadership and the use of techniques that are commonplace in world-class companies.

### **Finance manager skills and competences**

While many strategic finance managers are highly skilled there is arguably a lack of modern skills in particular areas. Some of these skills are technical and include cost analysis, financial forecasting, and financial modelling, while others are more behavioural and interpersonal, such as presentation, communications and networking skills. The research team suggest that professional accounting bodies may want to review whether or not their on-going continuing professional development (CDP) programmes and syllabuses strike the right balance between financial reporting/financial accounting themes and management accounting/financial management and business themes. Financial professionals of the future need to be as equally comfortable with calculating social returns on investments as they currently are with calculating financial returns on investment.

### **Barriers**

It is important to highlight what might be seen as some of the barriers to good strategic financial leadership. Firstly, lack of political direction in (say) a local authority can inhibit the role of strategic finance managers since there is no clear narrative with which to work. Secondly, there is a lack of support from within

the organisation, particularly from boards and chief executives, who sometimes appear to have a separate agenda. Thirdly, lack of resources in the strategic finance function is an inhibiting factor. In some cases organisations were facing capacity issues for the future. Having cut their finance functions, as part of a general cull on overheads, sometimes by 20% to 30% they were now questioning their ability to provide sufficient financial skills to meet new challenges. Fourthly, and reflecting one of the challenges referred to in Chapter 4, there is a lack of relevant quality-assured data and information. The latter two are inevitable in a time of austerity but focusing on the development of a business-partnering model should give more credibility to the strategic finance function and be more likely to attract new resources.

### **COMPARISONS WITH BEST PRACTICE IN THE PRIVATE SECTOR**

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Early in 2013 the Institute for Government published a report entitled *Financial Leadership for Government* (IfG 2013). The report compared and contrasted financial leadership in UK central government with that in the private sector and made a number of important points, including a view that strategic roles are often weaker at the centre of government than in large private businesses. Hence during the course of the present study, across the broader public sector, the researchers also considered such comparative issues between public and private sector. Some key problems noted are mentioned below.

### **Over-enthusiastic entrepreneurialism**

Several examples of what might be regarded as 'entrepreneurial activities' (involving pricing, purchasing and borrowing decisions) were identified



during the research team's interviews, which were seemingly not supported by a robust and relevant analysis and had had no planning for their long-term financial or reputational impacts. This contrasts with a truly entrepreneurial environment in which careful financial and scenario planning, including sensitivity analysis, would have been an essential precursor to such activities in order to ensure a fit with strategy and minimise risk.

#### **Joint ventures**

Some local authorities had been involved in very successful joint ventures with neighbouring authorities, for example in areas such as waste collection services. While joint ventures are not uncommon in the private sector, they are framed in the context of a competitive situation. In the public sector, where such a competitive position does not generally arise, there should be much more scope for co-operation and cost saving. However, during the research very few examples were uncovered. Despite the potential for efficiency gains and cost savings to be made by the relatively simple task of combining common back-office functions (for example, finance transaction processing) these opportunities had been rejected by some authorities for unspecified or vague reasons associated with a perceived loss of control. Such opportunities were unlikely to have been rejected in the private sector for such spurious reasons.

#### **Strategic finance role**

It became very clear during the project that although the basic operational functions of finance were being provided satisfactorily in most organisations, the strategic role for finance was limited and was in danger of being further reduced because of the need for efficiency savings. In some

cases, removing a layer of management as part of a cost-saving programme meant that the most senior financial post was now an operational and not a strategic role, with a consequent gap in representation at the most senior level of management. In the private sector it would be unusual for a board concerned with strategy development not to have strong financial representation.

#### **Financial control of budgets**

In some organisations, control of budgets appeared to be very poor, with a 'flexible' attitude being taken to managing commitments and allowing overspend. This would not be acceptable in the private sector. Budgetary control is a very basic and widely used technique, and is of considerable importance in managing the use of resources. In times of financial constraint, budget management should assume a greater level of importance.

#### **Use of financial management techniques**

Most organisations provided good basic financial information through their finance teams. However, few made use of sophisticated modelling techniques or analytical tools to add value to that data and help make better decisions. This is surprising given the size and complexity of the organisations, the challenges they face, and the level of financial skill available to them internally or from external sources. In one NHS example, although a 'goldmine' of excellent management accounting information was produced by the finance staff and presented in an easily absorbed graphical format, and despite employment of finance business partners to support function departments, the information was substantially ignored by operational line managers and appeared to be used only sparingly at CEO and board level.

#### **Home grown' senior staff**

There were several examples in organisations interviewed of long-serving 'home grown' senior financial and executive staff who had worked their way through the ranks within the same organisation during several decades' employment there. While they were clearly familiar with their own operating environment they sometimes demonstrated a limited appreciation of the need for a clear strategy and appeared to provide little innovation or leadership in solving the new challenges faced by their organisations. Private sector organisations of similar size and complexity would usually have senior executive staff who could capitalise on a proven track record elsewhere and who had gained from a wider range of previous appointments.

### **CENTRAL GOVERNMENT**

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At the outset and during the course of this project the researchers were unable to get any direct engagement from central government despite strenuous efforts to obtain this. Consequently, this section of the report relies on published studies and information, and on opinions provided by informed commentators (eg retired civil servants, think tanks, auditors).

In recent years there has been an increasing barrage of criticism of the UK civil service and just a few examples are worth quoting. In April 2013, Jonathan Powell, the chief of staff to Tony Blair, the former prime minister, claimed that Britain's civil service is like an insular 'monastic order' that thinks the same way and 'lacks the skills for coping with a modern society'. In a damning indictment of the officials he worked alongside in Downing Street for 10 years, Powell said there was a 'strong case' for a Royal Commission to be set up to forge a new system of



governance. Recently, Tony Blair himself said that he believed that the civil service was 'hopelessly bureaucratic' and no longer fit for purpose. 'Time has passed them by', he said.

On the other side of the political spectrum, the Cabinet Office minister, Francis Maude, has made many criticisms of the civil service both before and since gaining office. In January 2013, Maude claimed that civil servants are, at times, ignoring the direction of government ministers. He called for reform of the civil service and said it must become 'less bureaucratic' and that civil servants must work to implement ministers' priorities. Maude has now commissioned research into how foreign governments make civil servants personally contractually accountable for fulfilling ministerial objectives. A former minister, Nick Herbert, said his experience of the civil service while serving as a minister made him 'question whether the model still works'. He stated that the television comedy, 'Yes Minister', is an 'essential training manual' for members of the government.

With regard to financial management in central government, and starting with published reports, there has been a lot of criticism of financial management in central government. In 2008, the Public Accounts Committee (PAC) in its report *Managing Financial Resources to Deliver Better Public Services* (2008) stated that:

- there was a lack of financial management skills in government
- only 41% of departments' policy proposals included full financial appraisal
- only 20% of departments' policy decisions were based on a thorough financial assessment

- there was no significant improvement in forecasting and in-year monitoring of expenditure (PAC 2008)

Subsequently the PAC stated that 'Government organisations have been successful in improving their resource management, but a lack of financial management skills amongst non-finance staff is a barrier to further progress'.

Early in 2013 the Institute for Government published a report entitled *Financial Leadership for Government* (IfG 2013). The report compared and contrasted financial leadership in UK government with that in the private sector and made a number of important points.

- Strategic roles are often weaker at the centre of government than in large private businesses.
- In some areas, such as supporting performance management, central leadership roles are relatively underdeveloped.
- The structure of financial leadership in government, at a cross-departmental level, is more fragmented than that typically found in a private sector environment.
- The UK's Treasury does not take a leading responsibility for supporting performance management. The Cabinet Office takes on this responsibility.
- The position of the leading finance professional in government is relatively weak, being a part-time post, acting as a first among equals but with no formal input into key decision-making processes.

- These weaknesses appear to be specific to the UK and it seems clear that the UK government needs to strengthen its performance management and financial leadership.

In June 2013, the National Audit Office (NAO 2013) published a report entitled *Financial Management in Government*. Initially, the report outlines the challenges faced by government and the potential roles to be played by financial management and financial managers in this situation. The report then notes that there have been signs of improvement in financial management in government, as well as greater recognition of the strategic importance of the finance profession. It states that there was positive progress in relation to leadership, financial management processes and management information. Even so, while noting this progress the NAO report also comments that none of the improvement processes had been completed. It states that on management information, government remains a long way from ensuring that decision-making is routinely based on appropriate and robust information. Unit cost data are not systematically collected across government, and when efforts have been made to gather such data (for example in the 2010 spending review), the data were limited and inconsistent. The NAO report says that the progress so far does not mean that government is well placed to meet the forthcoming challenge of continued fiscal consolidation alongside substantial demand pressures.

The actions of central government can have serious implications for the rest of the public sector. In undertaking the case study work, the researchers heard strong criticism from the case study public authorities about the quality of

financial management in central government. There were complaints about:

- organisations being given difficult financial issues to deal with that central government was reluctant to tackle
- being the victims of unintended consequences as ill-thought-out policies were implemented without proper consideration
- a lack of consultation in advance on policies and issues associated with implementation
- the arbitrary nature of in-year budget changes
- costly and wasteful competitions for scarce resources.
- too little coordination on policies between government departments
- the reappearance of ministerial or policy-based evidence making rather than evidenced-based policymaking
- no overall sense of a vision of the goal and shape of the future public sector.

While most people said (as did the Public Accounts Committee) that some progress has been made it was emphasised that the rate of progress was far too slow and nowhere near fast enough to meet the financial challenges of the day. Some informants argued that there was (through the media) too much in the way of public relations initiatives about the development of financial management, and not enough emphasis on the substance of any improvements.

Turning to the research findings, a number of other specific points were emphasized by our interviewees.

While there are many hundreds of accountants now employed in central government, it is not always clear what roles they fill or what qualifications/ experience base they have. It does seem to be the case that finance professionals are just not sufficiently engaged in the financial evaluation of public policy or the financial planning of expenditure reductions consequent on the policies of austerity.

There appears to be a significant emphasis on the process of financial reporting and the production of statutory financial accounts (including compliance with domestic and international standards). While such an emphasis is laudable and understandable, we do question whether there is a sufficient and/or equal emphasis placed on modern and sophisticated approaches to financial management and management accounting practices in central government. We are aware, for example, of strong criticisms being made about the inadequacy of financial forecasting methods in central government.

Significant improvements are needed in the skills base of central government accountants in areas such as; costing, financial forecasting, performance management, financial strategy, etc. However, investment in such skills development would be a waste of resources if those skills were not subsequently utilised.

There is no strong coordination of attempts to improve the standards of financial management across central government.

Our interviews also reinforced a strongly held view that improvements in financial management practices in government are inhibited by huge cultural barriers. The attitudes of professional economists and generalist civil servants was seen to be one of ignoring the potential contribution that financial management can make to government decision making, especially in a time of austerity. Such attitudes are almost unique and would not be found in other parts of the UK public or private sector or in advanced Western economies overseas. Finally, the culture of secrecy in central government inhibits any real consideration of progress being made by external parties, apart from access given to organisations such as the NAO.

## 7. Conclusions and recommendations

### CONCLUSIONS

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The conclusions from this study are summarised below.

Austerity is creating huge and unprecedented challenges for public authorities in the UK.

On the basis of the research for this study it can be seen that many public authorities have responded well to these challenges and have so far dealt with the reductions in funding without disastrous consequences for service standards.

Leadership in a time of austerity poses different challenges from those encountered in a time of growth, and different skills will be needed.

The strategies developed by the case-study authorities, although financially grounded, do not appear to have longer-term sustainability or to maximise public value.

Strategic working at the multi-agency level is generally seen as an important issue for service provision and public value. In practice, however, it is seen as 'too difficult' and senior managers are unable to devote sufficient time to it because of other pressures.

The finance function has made a large contribution, at all levels in organisations, to the development and communication of strategies to deal with the pressures of austerity and other factors.

The finance function has demonstrated good leadership in developing and implementing strategies but for this to be successful it requires support from finance directors and chief executives.

Some public authorities have developed strategic finance teams to support the development of certain strategies, and this should be seen as good practice.

Strategic financial managers need to develop sustained business partnering arrangements with service managers.

There is an acute need for skills development among some strategic financial managers – technical, behavioural, managerial and interpersonal.

There is a pressing need to strengthen financial management in central government, particularly in relation to strategic financial issues. It is to be hoped that the recently announced review of finance across central government will seriously address the shortcomings identified, repeatedly, by many commentators and will be a starting point for driving forward change.

### RECOMMENDATIONS

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The researchers are wary of making too many recommendations since there is no clear way of assessing how difficult it would be to put these recommendations into action. Nonetheless, for completeness a few recommendations are listed below.

#### Strategy development

Further useful work could take place in providing suitable training and development opportunities to help people develop strategies. This could include training courses, sponsored events, mentoring, and peer reviews.

#### Finance leadership

Leaders of the finance function should always be at the most senior level of the organisation, as business partners.

Failing to include a senior finance professional, with an ability to see the long-term financial impact of strategic decisions, risks losing the ability to generate long-term gains in efficiency and effectiveness.

#### Senior finance staff

These should be professionally qualified and widely experienced. Wide experience can mean in the private or public sectors or both, but brings a range of knowledge and perspective from which the organisation will gain. Senior finance staff must not only have technical financial skills and wide experience but also need to demonstrate strategic leadership skills through both formal training and experience.

#### Finance leadership skills

It is important for senior finance staff to demonstrate strategic leadership skills as well as technical skills. These can be developed through both formal training and experience.

#### Financial management skills development

Finance leaders should consider whether they are using the full range of up-to-date techniques to support their organisation. Examples might include the use of the latest analytical tools linked to modern ERP systems, forecasting methods, the use of Balanced Score Cards, reporting, using forward-looking budgets and targets, key performance indicators, and benchmarked comparisons with other organisations. In the future, a wider range of techniques will need to be used, particularly in the area of estimation and forecasting, and this implies that supplementary training and development courses will be needed for finance managers across the public sector.

**Public engagement**

One of the key areas that the study found to be weak was the engagement of the public in a wider debate about the nature of public services in their area. Again there is a need for finance (and other) managers to tackle the tasks of engaging the public more widely in the next and more difficult stage of the response to austerity.

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