

The difference between the public and private sectors

By Per Koch

In the Publin report D9 *On the differences between public and private sector innovation* Ian Miles and Rannveig Røste argue that there are great differences between the public and private sectors as regards innovation. They point out that public organizations are typically the primary supplier of services and are not competing in order to maximize profits. This lack of product competition is widely held to mean a lack of incentives to improvement.

However, as Miles and Røste point out, the notion that the connection between a firm's behaviour and pecuniary reward is the central dynamic of economic rationale and the development of innovation has to be seen as too simplistic. Frost and Egri consider that there is a "rational myth of innovation" that portrays organizations as goal-directed.

One important outcome of the Publin project is that we have learned more about innovation related human behaviour in general, and that this knowledge may also be used to get a better understanding of incentives for innovation also in the private sector.

We have found that public sector workers may be motivated by idealism, the joy of creating something new, an intense interest

in the topic at hand, friendship and a sense of belonging, career ambitions, etc.

One obvious difference between the public and private sectors is that the public sector is



not profit driven in the business sense of the term. However, the motivations for innovation found in the public sector are probably also present in private firms, and definitely in third sector organisations.

The fact that public institutions are not profit driven, should not lead us to believe that public sector employees and managers are not concerned about financial matters. As is the case *within* private companies, public sector units and organisations fight for funding and influence.

Another factor that makes the public sector different from the private is the unit of analysis. Apart from publicly owned companies, most public institutions are part

of a larger chain of command and control where it is harder to draw a line between the different parts of the system – and where legal frameworks provide little help in this. For instance: public agencies – like research councils or directorates of health – interact closely with ministries as well as subordinate institutions and “users”. The innovation activities in these institutions are heavily influenced by decisions made above and below in the chain of command. The closest parallel in the private sector will be large conglomerates or multinational companies.

Another important difference is that the political aspect is much more important in the public than in the private sector. Policy decisions normally affect companies indirectly, through laws, regulations and financial support. The public sector is at least formally controlled by elected politicians. The intimate link between this governance dimension and funding of current expenses of the activities implies a very strong link between ownership and control on the one hand and the growth strategies of the subsidiary organizations.

Just as important are the differences in management incentives. Public managers are in general more likely to receive lower and less performance based material benefits, which may influence their willingness to take risk. It may be that the public sector – on an aggregate level – recruits fewer risk-taking entrepreneurs than the private sector relatively speaking, due to the expectations of rewards or penalties of entrepreneurial activity.

Moreover, it is likely that innovative private companies are more likely to accept “failure” than public institutions. By “failure” is here meant innovation projects that do not accomplish their expected objectives. Private companies may consider “failures” an integrated part of any risky enterprise, while the pressure to short term economizing of public funds – and not wasting the public purse – may imply a critical disincentive to innovation. Overall we would then expect to see public organizations being risk-averse relative to market-oriented firms, essentially due to the characteristics of the effective incentive system facing the two kinds of organizations.

Differences between private and public sector innovation

	Private Sector	Public Sector
Organising Principles	Pursuit of Profit, of Stability or of Growth of Revenues.	Enactment of Public Policies.
Organisational Structures	Firms of many sizes, with options for new entrants.	Complex system of organisations with various (and to some extent conflicting) tasks
Performance Metrics	Return on Investment	Multiple performance indicators and targets
Management Issues	Some managers have considerable autonomy, others constrained by shareholders, corporate governance, or financial stringency. Successful managers liable to be rewarded with substantial material benefits and promotion.	While there are efforts to emulate private sector management practice, managers are typically under high levels of political scrutiny. Successful managers likely to receive lower material benefits than comparable private sector managers.
Relations with: ~ End-Users	Markets may be consumer or industrial ones, and firms vary in the intimacy of their links with the end-users of their products, but typically market feedback provides the verdict on innovation.	End-users are the general public, traditionally seen as citizens, though recently there have been efforts to introduce market-type principles and move to see them as customers or consumers.

~ Supply Chains	Most firms are parts of one or more supply chains, with larger firms tending to organise these chains.	Public sector is typically dependent on private suppliers for much of its equipment, and is a very important market for many firms.
~ Employees	Nature of workforce varies considerably, and relations between employees and management range from fractious to harmonious. Efforts are made in some firms to instil company loyalty and/or a customer-centric approach, but employee motivations are often mainly economic ones of securing a reasonable income..	Public sector employees are typically highly unionised (economists and social scientists in the central administration and health- and social professionals as nurses, social workers, child-care workers, teachers etc in the public services). Many are also professional workers organised through professional associations. While usual concerns about status and salary are experienced, many workers enter public service with idealistic motivations.
~ Sources of Knowledge	Companies have considerable flexibility in sourcing innovation-related information from consultants, trade associations, and public sector researchers, but many smaller firms have limited resources to do so.	Despite large resources, parts of the public sector may be constrained from using private sources of knowledge (other than those of suppliers). Public sector sources of knowledge (e.g. Universities) may be highly oriented to other parts of the public sector.
Time Horizon	Short-term in many sectors, though utilities and infrastructural services may have very long horizons	Short-term: policy initiated innovations need to pay off within the election period.

These must be considered archetypal features of the public and private sectors and their relations to the propensity and direction of innovation. Based on a table developed by Ian Miles (2004). See Publin report D9 [On the differences between public and private sector innovation](#) by Thomas Halvorsen, Johan Hauknes, Ian Miles and Rannveig Røste for a more elaborate version.

Conference on innovation in the public sector

The PUBLIN conference, *Breaking New Ground: Innovation in the Public Sector*, was arranged on September 22-24 in Cork, Ireland, collaboration with the Department of Government, University College Cork.



Among the speakers and chairs were *Mr. Dick Spring*, former Irish Minister for Foreign Affairs, *Mr. Kevin Murphy*, former Ombudsman & Secretary General for Public Services Management and *Professor Wayne Parsons*, Queen Mary & Westfield College, University of London.

Several of the PUBLIN researchers presented papers at the conference.

For more information and conference papers, see: www.ucc.ie/acad/govt/publin/innovationinpublicsector.htm

Publin policy workshop in innovation in the public sector

The EU Publin research project invited policy makers and others involved in public sector innovation policy development to a workshop in Brussels on December 2 2005.

At the workshop, which was supported by the Research Council of Norway, Publin researchers presented some of the major findings from the research project. Moreover, policy makers were invited to share their experiences from public innovation processes. The overall objective of the workshop was to discuss concrete policy strategies aimed at strengthening public sector innovation.

Powerpoint presentations are available from the Publin website:

www.step.no/publin/workshop.html

Nordic project to follow up Publin

The Nordic Innovation Centre, an organisation under the Nordic Council of Ministers, has financed a smaller Nordic study on innovation in the public sector that is to be based in PUBLIN.

Interact will study how the mixed arrangements in the public health and social service sectors in the Nordic countries facilitate and restrain innovation in the public sector. The overall aim is to develop a "road map" of how processes of technological development, policy learning and development of better quality services unfold in the public sector.

Moreover, the road map will contribute to an understanding the complexity of learning processes in the public sector in general, and the success and shortcomings in the existing policy measures. In that way, Interact may contribute to the development of policy measures enhancing innovation in the public sector.



The following institutions take part:

- NIFU STEP - Studies in Innovation, Research and Education, Norway.
Per Koch, Johan Hauknes, Marianne Broch
- Roskilde University, Denmark.
Lars Fuglsang
- VTT Information Technology, Finland.
Niilo Saranummi.
- Granskingarráðið, Faroese Research Council (FRC), the Faroe Islands.
Rúna Hilduberg, Heini Hátún
- RANNIS, Rannsóknamiðstöð Íslands, Iceland.
Thorvald Finnbjörnsson.
- SISTER, Swedish Institute for Studies on Education and Research, Sweden.
Enrico Deiacò, Peter Schilling

For more information, see www.step.no/interact.

The PUBLIN book will be published in 2006

By Paul Windrum, Manchester Metropolitan University

The British publisher Edward Elgar has agreed to publish a book based on PUBLIN papers in 2006. The book, which is edited by Paul Windrum and Per Koch, will be called *Innovation in Public Sector Services: Management, Creativity, and Entrepreneurship*.

The following is a brief description of the rationale for – and the content of – the book.

The book is to fill a fundamental gap in innovation studies: it addresses and seeks to explain the dynamics of public sector services innovation. The key contributions of the book are

- a consistent and general basis for understanding the dynamics of innovation in public sector services

- the book draws on theoretical and empirical research conducted in the PUBLIN project

The novel elements of the book are

- a taxonomy for studying public sector innovation
- novel research themes: the importance of *management*, *creativity*, and *entrepreneurship* in public sector innovations
- a methodological approach for studying public sector services
- aggregate empirical studies of public sector innovation across the EU
- empirical study of user views across the EU
- individual case studies: policy and service level studies in health and social services



Public sector innovation is a key contributor to national growth and to the welfare of individual citizens across the developed world. Yet, precious little research on public sector innovation exists. In part, this is a legacy of the old view that held that manufacturing is the sole source of productivity growth and economic wealth, while services are unproductive and technologically backward.

This old view has been demolished in recent years in research on services innovation in the private sector. Now is the time to critically evaluate the contributions of innovative public sector service providers.

The first task of the book is the development of a clear categorisation

of the different types of innovation found in public sector services. The word 'innovation' is not commonly used in public sector (unlike the private sector). Instead, words such as 'policy change' and 'reform' are used. Yet innovation certainly exists in public sector services. On a daily basis, novel ideas and technologies are developed in public health and medicine, in universities and in general education, and in social services.

In the book, a new taxonomy of public services innovation is developed. The taxonomy comprises the following types of innovation:

1. *product innovation* taking the form of new / improved services. This type of innovation is what researchers have traditionally called 'technological innovation'.
2. *service delivery* (equivalent to process innovation in manufacturing).
3. *administrative and organisational innovation*. This involves changes to the administrative structures in which people produce the services in a certain way (equivalent to 'front office' in private sector firms), and/or supporting services (equivalent to 'back office' in private firms).

Over the last 20 years, the introduction of New Public Management (NPM) has been a major current in organisational reforms in the public sector. The organisational principles of NPM are not radically new, but are new methods of organisation in the public sector that involve learning processes in the adjustments to specific requirements of the public sector activities.

4. *conceptual innovation*. New world views are developed that challenge the

assumptions underpinning existing service products, processes and organisational forms.

For example, assumptions about what should be provided by the State and the private sector have fundamentally changed in Europe since the late 1970s. Who should produce what, how, at what time, using what type of relationship structures, what management practices, what contractual obligations, and so on. NPM's private sector styles of organisation have introduced a new conceptual understanding of the role of the public sector.

5. At the ministerial level, we find *policy innovation*. This comes in two forms: incremental innovation based on policy learning by the government, and radical innovation sparked by conceptual innovation.
6. *systemic innovation*. Privatisation, and the contracting-out of public services, has resulted in new relations with private sector firms and non-governmental organisations, and fundamentally changed the public welfare system.

Discussions of innovation in public sector services highlight the importance of *management, creativity, and entrepreneurship*.

Again, there has been much discussion of their importance in the private sector, but little discussion of these in the public sector.

The book addresses, and breaks open, the Weberian image of static bureaucracies in which new ideas are stifled. In its place, we find innovation 'champions' and 'policy entrepreneurs' who fit exactly Schumpeter's definition of entrepreneurship: they are willing to experiment and take risks in

applying, for the first time, radical new ideas.

These are either ideas which they have developed themselves, or else are the first application of ideas developed elsewhere. Of course, the environment within which these innovation champions and policy entrepreneurs operate is very different to private sector markets.

Social responsibility and accountability, plus the very different networks found in the public sector, give rise to a very different set of barriers and enablers for the diffusion of innovations. The book investigates the range of social, technical, and political 'management skills and knowledges' that are employed by public sector entrepreneurs on a daily basis.

The novel theoretical elements of the book are built on new empirical research that has been conducted at the macro, meso, and micro levels.

The books' contributors will present detailed analysis based on OECD data sets (to which they have had exclusive access), and case studies at the policy and individual innovation levels. The aggregate empirical study of public sector innovation across the EU (OECD data sets), is new and its findings are of great relevance. These highlight a tendency for convergence across EU states since the crisis of the State in the first early 1980s.

A new State is being constructed, the essential motives for which are political reform to increase the legitimacy of governments, fiscal adjustment, privatisation, de-regulation to reduce the size of the state, and administrative reform. The data indicates convergence, but it also indicates persistent differences within the EU in terms of taxation, spending, and levels of services provision. These are

associated with 4 models of European Welfare State: the Nordic-socialist model, the Continental-Christian Democrat model, the Anglo-Saxon liberal model, and the Mediterranean or Latin state model.

But the most important finding of the research is the following. The real association between public sector and economic growth cannot be derived from sizes of States and public interventions, but from the type of actions, the specific organisation of the administrations and the interrelations with society and private sector.

An efficient public sector, promoting productive investment and innovation is always positively correlated to economic growth and social development. An inefficient public sector, which only focuses on current spending levels and crowds out the private and social sectors, is correlated with economic stagnancy and perverse effects. This is why the empirical case studies of public sector innovations in presented in the book are important.

There will be several chapters devoted to individual case studies in public sector health services and social services. The case studies will operate at two levels. They will consider the macro/meso level innovation dynamics that exist at the policy level as well as the dynamics of the innovations within particular services (the micro level). The interaction of macro/meso level with the micro level is what makes these empirical studies novel.

Also, the contributors highlight the extent to which general trends exist at the macro/meso level. In health, for example, individual EU countries have different medical systems and histories, but important similarities exist. In terms of demographics, they all face ageing populations, rising total health costs, and a falling percentage of young working people who are being

required to pay for this ageing population. The result is a debate about role of the State and the role of private sector insurance firms in future provision.

Should there be a public sector system, operating on current transfer payments, or should individuals cover their own health insurance costs (as in the USA and in some countries in EU)?

In addition to overall rising costs, there is an increasing 'consumerisation' on the part of health services users giving rise to a new relationship between them and practitioners (GPs, hospital doctors and consultants, and

nurses). Users are no longer willing to be submissive patients, and are likely to litigate when errors are made.

Finally, the search for greater efficiency with public sector health provision by national governments has led to the introduction of new tiers of managers who are set targets by politicians, new management practices and styles, and institution-wise restructuring of public sector agencies.

The book will be published in the autumn of 2006.

New Publin report discussing the innovation concept

Since the previous issue of our newsletter, Publin has published a new report that gives a thorough discussion of the concept of innovation and the use of the concept within the context of the public sector.

The report, D20 On innovation in the public sector, also presents some of the main findings from Publin. This is not the final summary report of Publin, however. This more policy oriented report will be published in late December/early January.

A complete list of Publin reports can be found at www.step.no/publin/reports.html. All reports are freely available for download (PDF files).

New issue of the Innovation Journal

There is a new issue of the Innovation Journal out now. The issue includes these and several other papers (see www.innovation.cc/volumes-issues/vol10-no3.htm):

[Complex Adaptive Systems and the Diffusion of Innovations](#), by Everett M. Rogers, Una E. Medina, Mario A. Rivera, and Cody J. Wiley, University of New Mexico, USA

[Testing a Diffusion of Innovations in Education Model \(DIEM\)](#), by Mark K. Warford, Buffalo State College (State University of New York), USA.

[Towards an Innovation-driven Economy Through Industrial Policy-making: an Evolutionary Analysis of Singapore](#), by Andrew L S Goh, Department of Management, Birkbeck College, University of London, and Republic of Singapore.

Beyond Publin: Managing to innovate

Do the UK's voluntary organisations deserve their reputation for innovation? A new study tries to answer this question.

Being able to innovate (in other words, the ability to develop new ways of responding to existing needs or develop new services in response to emerging needs) is seen to play a key role in public service provision. Increasingly, public services are expected to be able to respond to the evolving and complex needs of local citizens in an efficient and effective manner. The capacity to innovate is therefore essential.



Voluntary and community organisations (ranging in size from large organisations such as Help the Aged to, for example, a small, local group for carers) have long held a reputation for being innovative. However this reputation is based on limited research. A new project led by *Stephen Osborne*, Professor of Public Management at Aston Business School, aims to provide more solid evidence on the nature and extent of this innovative capacity.

The project is funded by The Public Services Programme, under the Economic and Social Research Council of Britain.

The Public Services Programme brings in researchers from across the social sciences to explore questions such as:

- How are public services changing, who wants what, and how is quality to be convincingly measured?
- What are the effects of popular reform measures like incentive pay, targets, transparency?
- What can we learn by comparing current public service arrangements with past experience, by comparing experience across the UK, and by comparing the UK with other countries?

For more information on this project and the programme, see www.publicservices.ac.uk/our_research/Innovative_Capacity_of_Voluntary.asp

THE PUBLIN POST NEWSLETTER

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