
Perspective

Looking beyond short-term savings:
Transforming the Canadian federal and
provincial public sector





Striking the right balance: Revenue growth versus spending reduction Message from the Canadian Firm

The past decade saw the Canadian federal and provincial governments strengthen their balance sheets while responding to a diverse range of emerging policy issues. The fiscal performance of Canadian governments became the “gold standard” of leading practices in deficit and debt management on a global basis. Indeed, acknowledgement by the World Economic Forum rating Canada’s fiscal performance among the best of the G8 economies during the global crisis solidifies Canada’s reputation for prudent policy and fiscal management.

How quickly times change. The 2008-2009 global economic crisis sent shock waves through Canada’s major trading partners, and the ripple effect on the Canadian economy was immediate and severe. The call for a global response compelled Canadian governments to respond aggressively with stimulus to mitigate the most severe impacts of the economic downturn. Only now is Canada showing signs of recovery as the economy expanded for the third consecutive month in November 2009 according to reports by Statistics Canada. The majority of observers acknowledge that economic action plans, consisting of tax relief, financial assistance and stimulus efforts, have gone a long way to stabilizing the Canadian economy and restoring consumer confidence.

Yet, as we slowly emerge from the economic crisis, the fiscal outlook for Canadian governments remains challenging. Economic growth is not anticipated to completely fill the gap in government revenues. Future federal and provincial budgets will set out aggressive fiscal plans for returning government budgets to balance over the next three to five years.

A sustainable approach is critical

To reduce the fiscal gap today and for the future, governments must begin to set out transparent targets and timelines. Many may choose to address the gap by raising revenue through a combination of tax changes, asset restructurings or fees. Recently, the Federal, Ontario and New Brunswick governments all signaled that crown assets are being reviewed. With any initiative, however, debate will continue about the right mix of revenue enhancing actions versus spending reduction options.

It is PricewaterhouseCoopers (PwC) expectation that comprehensive spending reviews will play a significant role in the effort of Canadian governments to achieve their reduction targets. We also believe there are significant opportunities to reshape the way governments deliver programs and services to achieve sustainable cost improvements. The challenge will be for the public sector to restructure its costs without sacrificing advances in the quality of services that Canadians value. Efficiency must go forward hand-in-hand with service improvement.

Conventional approaches to cost management in the public sector have traditionally adopted a short-term focus, repeatedly targeting operational expenses (e.g. hiring freezes, reducing travel, deferring expenses). However, these approaches often fall short in addressing substantive baseline operating costs and third-party spending where real cost improvement opportunities exist.



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In our view, now is the time for governments to take a transformational approach to sustainable cost management, one that is comprehensive and bold. In this paper we set out an approach that combines immediate cost reduction actions with structural improvements to cost management to help achieve sustainable results.

Regards,

Mark Elliott

Cost management in the context of the unique challenges facing the public sector



Industries differ in their approaches to managing costs. What works in the airline or downstream energy industry may not work for the public sector. Addressing costs begins with understanding how business decisions affect the industry's cost base. There are many unique characteristics of the public sector which need to be considered in reducing the growth rate of government spending. Below are some of the unique challenges of addressing cost management in the public sector:

- Complex governance and decision-making processes with long lead times before desired benefits are realized;
- Public and stakeholder expectation that decisions will meet a high standard of transparency and accountability;
- The sheer size and complexity of government operations often leads to “boil the ocean” solutions because governments often struggle with how to get started;
- Multiple service channels and heavy reliance on third parties reduce the amount of control over costs and productivity;
- Labour costs account for a significant share of total spend and it's highly unionized workforce has contractual rights requiring care and attention in managing labour relations; and
- Parliamentary oversight focus on budget appropriations often masks the true underlying costs of programs and services.

In designing a comprehensive spending review program for the public sector, governments must address these challenges and find creative solutions to achieve sustainable cost management.

Why conventional approaches are often not sustainable

Governments are understandably anxious about the difficult decisions that accompany cost management efforts. Previous cost reduction measures have often been implemented without considering their sustainability. As a result, we believe government leaders should be asking, “What has to fundamentally change so that our cost reduction efforts work today as well as in the future?” rather than simply saying, “How can I save \$Xm in the next fiscal year?”

In our view, short-term traditional cost reduction efforts have fallen short in delivering sustainable savings to the public sector for five key reasons:

- 1. Costs are shifted, not eliminated** – Senior levels of government arbitrarily reduced budgetary transfers to the next level of government achieving spending reductions without reducing overall cost of operations.
- 2. Arbitrary targets** – The mantra was typically, “We have to reduce spending now and we don’t care how.” As a result, organizations directed to reduce spending by an across the board target often failed to prioritize initiatives. This resulted in cost-cutting without longer-term action, management or tracking plans. The random nature of the cuts typically led to negative impact on morale and culture.
- 3. Dipping in the same well** – A repetitive focus on so-called “low-hanging fruit,” such as travel, hiring freezes, administrative expenses and delaying capital investments, overlooked baseline operating expenses and third-party spending where significant opportunities may have existed.
- 4. Oversight in addressing cost management and controls** – Public sector organizations often reduced costs without addressing their spending culture. Even if internal control policies are in place, enforcement has been weak. Non-compliance was not monitored or reported on a systemic basis. As a result, since the rules are onerous they became viewed as something to work around, encouraging tolerance for exceptions.
- 5. Inability to measure results** – Cost reduction activities were often lost within annual operating results. Without a strong monitoring process, it is difficult to know whether cost reduction activities are achieving desired results.

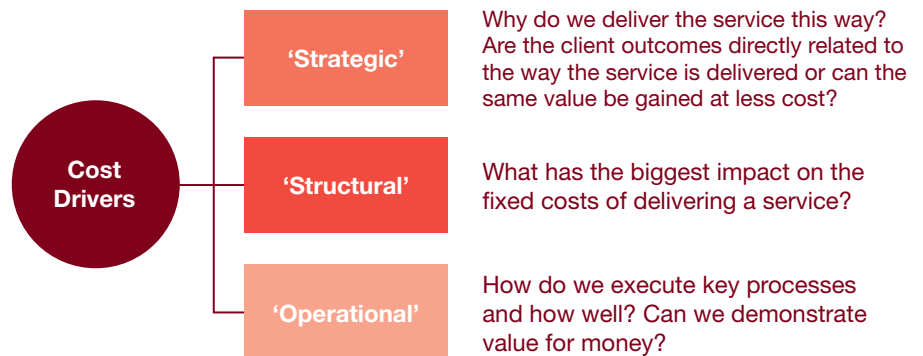
Understanding what drives costs

In order to address costs, it is critical to first and foremost understand how past decisions affect today's cost base. We believe there are three major cost drivers that shape the overall costs of delivering public services: strategic, structural and operational. Key questions to address within any spending review program should include:

In answering these questions there will be "public interest" matters that truly represent a strategic choice for the government. In many cases, the current program design and delivery is optimal

and just the cost of doing business in the public sector. Other cases, however, may simply be a function of conventional thinking where the answer is, "This is the way we have always delivered this program". The latter case provides an abundance of opportunities for review and potential improvement.

Once the answers have been identified, governments can begin to model a sustainable cost reduction management approach.



Sustainable cost management requires a portfolio approach

A comprehensive spending review program should adopt a portfolio approach and ensure that savings arise from all three cost drivers. In doing so, governments can deliver significant savings in the short term and use them to fund medium- to long-term sustainable cost improvements.

The table below highlights different cost-improvement initiatives that are often taken based on the three cost drivers. Each initiative achieves varied results, including the typical actions that are taken to reduce costs, the degree of savings and the time frame needed to achieve results.

While each cost improvement option will likely produce savings, in our view, to be effective, governments will need to look at all three cost drivers with a transformational lens. A comprehensive spending review program requires more than implementing operational and continuous improvement programs to close the gap. The constraints on funding must also be seen as an opportunity to innovate and introduce new ideas to the delivery of public services.

Cost Drivers	Cost Improvement Levers	Typical Actions	Typical Savings	Implementation Time Frame
'Strategic' What you do	<ul style="list-style-type: none"> Operating model Channel rationalization Program rationalization 	<ul style="list-style-type: none"> Redesign operational model Channel redesign Redesign eligibility or entitlement 	20-40 %	One to two years
'Structural' Where you do it	<ul style="list-style-type: none"> Increase scale Redesign process New technologies Alternative service delivery 	<ul style="list-style-type: none"> Optimize number & location of operations Process flow and design choices Fit-for-purpose IT platforms Rationalize facilities Consolidate back-office activities Outsource knowledge & routine work 	15-25%	Six to eighteen months
'Operational' How & how well you do it	<ul style="list-style-type: none"> People & organization Process improvement Risk and controls Procurement policies 	<ul style="list-style-type: none"> Strategic sourcing & demand management Redefinition of roles & decision rights Flat organization design Process simplification & standardization Manual versus automated work Simplified & harmonized IT infrastructure Expense reporting & control 	10-20%	Under six months

Transforming the Canadian federal and provincial public sector: five steps to success

So what should governments do? Whether assessing the whole of government or at the Department or Ministry level, the following five elements should be adopted in designing a comprehensive transformational review. Delivering lasting value successfully requires a focus on making the change stick, helping to ensure sustainable benefits long after project completion.

1. Articulate a compelling case for change and enhance capacity to make change stick

- Engage active political and civil service sponsorship
- Identify leadership and skills required to manage the transformation as a strategic initiative
- Ensure strong governance by involving key political stakeholders and organizational leadership
- Set clear vision for change and long-term goals
- Develop clear messages and deliver them consistently throughout the transformation
- Articulate necessary cultural changes
- Encourage ongoing involvement of people who will deliver the change in practice

2. Set targets and timelines

- Make tough choices on what investments will be made and what will be deferred or stopped
- Identify the programs that will continue to grow (albeit at lower rates), those that will be flat-lined and those that will be reduced. Avoid across the board targets.

3. Conduct citizen-centric cost-cutting reviews to identify opportunities for improvement

- Review programs from a citizen-centric perspective to identify innovative ways to improve service and change channels that no longer meet customer needs
- Programmatic reviews should be supplemented by cost-cutting or horizontal reviews that address functional aspects of government operations (e.g. shared services)

4. Underpin implementation with strong change and project management

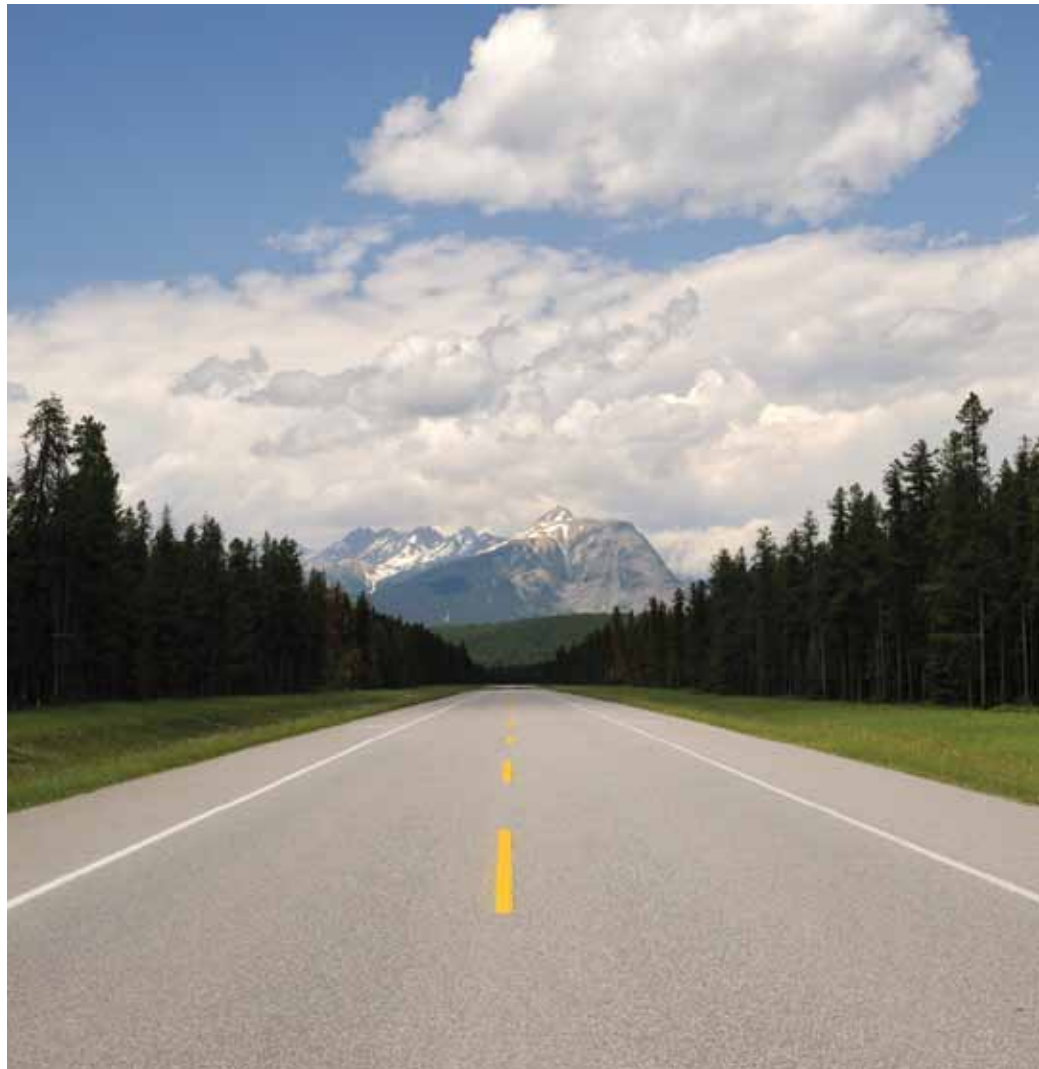
- Engage delivery agents and ensure strong stakeholder commitment to make change stick
- Build a team with skills and experience in delivering complex transformations
- Focus on achieving benefits and set up measures to realize them
- Rigorously apply project management discipline

5. Monitor performance and report results

- Continue to embed the new ways of working post implementation, making refinements as needed
- Provide ongoing support, training and performance management to those delivering the change
- Monitor activities, capture related spending results and provide robust reports for senior management

The way forward

Over the next several years, all governments in Canada will struggle to balance their books. PwC believes that now is the ideal time for governments to take a strategic and bold look at cost improvement opportunities. However, actions taken today will inherently affect the services and direction of tomorrow. This requires both short- and long-term approaches to be considered to address quick fixes, as well as substantive baseline operating costs and third-party spending. By following the five steps, governments can develop an effective cost reduction strategy that is sustainable and does not compromise future flexibility.



Need help designing a comprehensive review?

In this paper we outline several steps that you can incorporate into a comprehensive spending review initiative. We would be happy to sit down with you to identify the key cost drivers affecting your public sector organization and to identify pragmatic approaches to tackling these drivers. For more information on how we can help, contact the authors or a local member of PwC's Public Sector and Government practice.



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About PwC Canada's Public Sector and Government

PwC's public sector and government practice provides assurance, tax and advisory (consulting and deals) services to build trust and enhance value for its public sector and government clients and stakeholders at all levels—federal, provincial, municipal and aboriginal. With over 200 dedicated professionals in more than 21 Canadian cities, our network shares their thinking,

experience and solutions to develop fresh perspectives and practical advice tailored to the unique challenges of the public sector—insight that allows us to effectively improve the performance and enhance the accountability of government organizations. For more information, please visit www.pwc.com/ca/publicsector

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