

INNOVATION AND CONSTRUCTIVE CHANGE IN CUTBACK MANAGEMENT:

A COMPENDIUM OF RESEARCH AND COMMENTARY BY LOCAL GOVERNMENT LEADERS

Background paper for *Navigating the Fiscal Crisis*

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It is common to hear brave calls to take advantage of trying times to make changes. For governmental organizations faced with an economic downturn, it is no different. Here are samples:

- “A crisis is a terrible thing to waste.”
  - Governor Jennifer Granholm, Michigan (in Barrett and Greene, 2008)
- “In these economically challenging times, sophisticated managers see opportunity.”
  - Barrett and Greene (2008)
- “There’s no time like hard times to take a close look at duplicative programs.”
  - Feather O’Connor Houstoun (2009)
- “Well-run organizations not only survive economic downturns but also create the momentum required to excel.”
  - Bob O’Neill (2008)
- “A crisis forces people to look for different arrangements for how they deliver services. When times are tough, the politicians have the cover to make hard choices.”
  - Chris Hoene, director of policy and research for the National League of Cities (in Barrett and Greene, 2008)
- “The pressure to cut budgets is also an opportunity! It presents a chance to develop streamlined processes that the organization, management or employees might resist in normal times.”
  - Frank Fairbanks (2008b)

It is possible that organizations will use hard times as the occasion for introducing change, and these actions approximate the process of innovation. A demanding definition of innovation is an idea, practice, or product that is new, original, and cutting

edge. It represents the **invention** of a new approach. A broader definition covers introducing change with the intention of improving process or results. The action is new to the organization and a departure from previous practice but not necessarily an original idea. This form of innovation involves the **adoption** of practice from another government or the incorporation of leading practices not formerly used. The destructive aspects of retrenchment with the loss of good people and programs makes it hard to look at a cutback period as a time of innovation. Such periods, however, are characterized by widespread change, and we can learn from the innovation process to understand how this can happen at the same time as we recognize the special demands of achieving cutbacks.

One similarity between innovation and the response to cutbacks is that a “negative” stimulus is usually the prompting factor for action. Sanford Borings (2001), in his examination of local governments recognized in the *Awards for Innovations in American Government* program, has discovered that the factors that prompted the innovation were usually change forced by election outcomes, legislative mandate, or external pressure (26%); crisis (26%); or problems identified internally that need to be addressed (61%). A “positive” stimulus such as a new technology or learning about an exciting new approach accounted for only 13% of the innovations. Thus, the experience of innovative local governments supports the aphorism that “necessity can be the mother of invention.” Unfortunately and more commonly based on what we have learned from previous cutback periods, necessity can also be the mother of reaction. David Ammons of the University of North Carolina has identified the counter-innovative factors at work:

Tough fiscal times can sometimes bring actions that smother creativity. Governments may ... manage the crisis not by careful strategic moves but by hiring freezes and across-the-board cuts. That's the risk in times of crisis (in Barrett and Greene, 2008).

Under normal conditions, innovation is optional. Governments may choose to pursue it or not. In a period of retrenchment, change definitely will occur because the decline in resources means that the government cannot maintain the status quo. In this sense, hard choices are automatic, but it is not certain whether the choices will be proactive or reactive. Will they be selective, strategic, and even constructive, on the one hand, or arbitrary and oblivious to differences in quality and need, on the other? There are three conditions that support renewal rather than reaction:

- Changed political climate makes formerly nonfeasible options possible.
- Challenging circumstances lead to considering options not seriously considered before.
- Pressing need leads to unleashing the creativity of participants in the local government process to come up with innovative possibilities.

Whether a local government is able to use cutback to stimulate constructive change depends on several factors. Some governments are better prepared to deal with the crisis because they meet certain preconditions. These will be considered first and then the discussion turns to the qualities that all organizations need when the crisis comes.

### Preconditions that Can Help Deal with the Crisis

In the opening statements that link crisis and opportunity, there are important prior conditions. It may be “sophisticated managers” in “well-run organizations” that distinguish successful government organizations from the rest. Research on innovation has revealed a paradox: governments that need innovation most are the least likely to undertake it because they lack capacity, commitment, and imagination. They may also lack financial resources, but cutback periods demonstrate that limited or declining resources do not preclude constructive approaches if the other conditions are present.

Some governments handle cutbacks better because of they have made preparations in advance of the crisis or have strong organizational capacity for leadership, analysis, and decision making. Recognizing the value of these factors is important for understanding why some organizations succeed and others decline. This does not mean, however, that the ability to cope and rise above adversity is predetermined and beyond the control of leaders. The positive qualities provide an inventory for managers to use in taking stock of their own capabilities. There may be time to put some of these features in place before the financial challenges become more serious in the current cutback period. For example, the management team in Queen Creek, Arizona seeing declines coming held a retreat to refocus on core services and got the council to endorse these as priorities that would be preserved when cuts had to be made.

Here are some steps that been taken or systems that help local governments deal with a crisis when they have been established in advance:

1. Understand community values and establish priorities to guide choice of programs and services to be preserved or reduced.
2. Forecast trends and establish an early-warning system to discern which environmental trends and factors will have an impact on strategy and timing. Cross-check forecasts from separate sources.
3. Implement a strategy for increasing fiscal sustainability by creating a balanced array or revenues that respond differently to stages in economic cycles.

4. Budget cautiously in good times. For example, Chandler, Arizona budgets 92% of its general fund (Focus Group, 2009). Reserve funds that build up can be used to even out fluctuating revenues and deal with emergencies.
  
5. Establish sound policies for reductions in force or early retirement before they have to be used as suggested by Sarasota County Manager Jim Ley (Webinar 2008) and Phoenix City Manager Frank Fairbanks (2008b).
  
6. Define key service delivery areas and using performance indicators to measure results. Rigorous analysis determines whether programs are working. If cuts are needed, the government can use these indicators to identify the relative effectiveness of programs and services.
  
7. Create enterprise funds for cyclical activities with staff appointments linked to the level of activity.

These features provide a guide to organizational building to prepare for the next crisis and also for more successful organizational performance in “normal” conditions. If they are not present, local governments may consider putting them in place to be better prepared for the future. For example, Washoe County, Nevada, started a citizen involvement process during the downturn in 2003 that has been an asset for identifying priorities before the current crisis even started (Simon 2008).

#### Ready Or Not, Here Comes the Crisis: What Managers Can Do

As local leaders confront the financial strains and make cuts, their response needs to include three elements: leadership style, involvement, and constructive actions. They are all interrelated but each will be described separately.

##### A. Provide Positive Leadership

Regardless of the conditions in place before the start of a cutback period, there are key leadership characteristics that need to be displayed when the crisis begins.

*First*, top administrators need to be honest, independent leaders who advise and support elected officials. This is the standard expectation for city and county managers, and it applies to the highly charged atmosphere of budget cutbacks. Managers must avoid either shifting too much responsibility to elected officials, on the one hand, or making critical decisions autonomously, on the other. Top administrators need to alert elected officials of the changing conditions. They should frame the strategic choices to help elected officials establish the priorities for program and service review early in the process, and they must provide as much information as possible about options and

consequences of specific cuts when they present recommendations to elected officials for final decisions. Las Vegas City Manager Elizabeth Fretwell (2009) offers this advice:

When staff are able to clearly identify all the budget-cutting options and present them in a nondefensive way so that the elected officials have a reasonable time in which to consider all the implications, the elected officials can focus on what the city really has to do. Keeping the council fully advised is as important as anything else that is done in a retrenchment program.

Just as the top administrators must avoid doing too little or too much in shaping the response, they should help elected officials steer clear of micromanaging the cuts, on the one hand, or avoiding responsibility for decisions, on the other. Although some council members may not want to have their “fingerprints” on cuts, as an Arizona city manager suggested, they cannot avoid taking responsibility for supporting the broad parameters of the cutback approach and for accepting the final specific decisions that are made (Focus Group, 2009).

*Second* but simultaneous to the first, managers must set the tone for the discussion of cutbacks. They must signal that the organization is going to look for ways to become stronger and make the process a healthy experience, not just hunker down. They must also be able to offer a vision of how the organization can be different, “imagining the government post-recession” or looking for ways to “resize and restructure.” Managers also convey the realization that the conditions are real, and that elected officials, staff, and citizens should not expect that the government faces just a temporary shortfall (Focus Group, 2009).

*Third*, managers need to encourage widespread involvement within the organization. A natural impulse is to tighten control and limit the discretion of department heads so that conditions do not get out of hand. Innovation research demonstrates clearly, however, that positive change is not a top-down process and that ideas for innovations come from all levels in the organization. For example, Borins research on award winning ideas shows that far more new ideas come from mid-level and front-line staff than from the top administrator. Since Peters and Waterman’s (1982) *In Search of Excellence*, there has been recognition of the need for “simultaneous loose-tight properties” to achieve the highest level of performance. Top officials provide central direction in setting goals and stressing core values while giving freedom to staff throughout the organization to come up with the ways to meet those goals. According to Phoenix City Manager Frank Fairbanks (2008b), “budget pressure can motivate us to explore the concept of giving employees more independence of action, to allow increased personal initiative to meet the public's needs.”

*Fourth*, managers open up the process to new ideas by insisting that everything is on the table and any ideas will be considered. Fretwell indicates that it is “imperative to quickly get beyond the we-looked-at-this-before statements and haven’t-we-plowed-that-ground-already arguments.” Tom Bonfield, City Manager of Durham, North Carolina, argues that it is important to dissect public safety department programs and analyze them separately to avoid the “we can’t cut police and fire mentality.”

*Fifth*, in cutback periods as in other times, managers must push for excellence and seek to improve the current level of performance. Scarcity is no excuse for lowering standards.

### B. Encourage involvement

It is critically important for managers to be committed to communicating with all stakeholders. Mobilizing the media is essential to explaining the nature of the need, what actions are being considered what their consequences are, and explaining what decisions have been taken.

Department heads and staff should be fully involved in preparing cuts. The choice of cuts is informed by the in-depth knowledge that departments have. Staff members at the operational level may see ways to reduce the impact of cuts on service delivery that are not obvious at higher levels. Ultimately, the success of the cutback plan depends on the understanding and commitment of the department directors and staff.

Working with the community is important in developing budget cuts. Ideally, citizens have been involved in the process of identifying priorities in advance of the budget crisis.

As noted previously, the Washoe County Commission empaneled a broadly representative committee called “Charting Our Course...Investing in Our Future” in 2003. The committee examined program prioritization, revenues generation, and operating efficiencies, consolidations, and outsourcing. The committee’s recommendations developed over a six month period have been used to prioritize things like infrastructure investments, technology, program enhancements, and budget reductions. As Cheryl Hilvert, City Manager of Montgomery, Ohio, points out, “Community Matters!” in setting the agenda for addressing budget shortfalls.

Citizens should have extensive opportunities to respond to proposed cuts. Even though citizens were involved early in the process, County Manager Katy Simon in Washoe County, Nevada, says that in a budget crisis it is important to “redouble efforts” to communicate with citizens: “Involvement can take the form of surveys, citizen committees, town hall meetings and community forums, as well as volunteerism programs to offset lost resources.”

Paying attention to staff members is also crucial. Valuing ongoing relationships help to get the organization through hard times. Top administrators should not only invite the

ideas of employees, but also be open to expressions of their feelings and concerns. Job security is a highly salient issue of staff members, and provision should be made for counseling services for those who may lose their jobs as well as those left behind. Departments should be encouraged to accept new staff assigned due to transfers and to help make the transition successful.

Another part of communicating with staff is providing information as soon as possible. Charlie McClendon, City Manager in Avondale, Arizona, realized that delaying the announcement of which five percent of the workforce was going to be laid off was paralyzing the 95% who would keep their positions. Ed Beasley, City Manager of Glendale, Arizona, observes that the staff members in city and county government are important sources of information dissemination through families, friends, and neighbors. If staff members are scared and uncertain, they communicate that fear to residents of the community. An informed staff engaged in constructive actions to offset the effects of the downturn can be ambassadors to help relieve fears in the community.

### C. Take Constructive Actions

A range of actions can be identified for responding in the short-term and the long-term challenges of a fiscal crisis.

#### Cut quickly

Local governments need to act quickly to respond to trends and indicators of decline. Although managers may want to delay action and avoid long-term choices while waiting for normal conditions to return, Fretwell argues that “management needs to devote as much time as it takes to convince elected officials, employees, residents, and media that not only does a problem exist but urgent attention is required.” Ignoring the signs and delaying action make the situation worse and reduce later options. Adjustments to the current budget start producing savings and relieve some pressure on the next budget. Governments should also declare a hiring freeze early. This creates a pool of vacancies that can be used to place employees whose current positions are cut later in the process.

It is useful to identify the options for transfer/severance/retirement before any specific positions are even identified to be cut. Retirement incentives should be used to save a layoff of another person, not just to remove a staff member who has to be replaced. These initial necessary reactions to drops in revenue help to insure that the resources are available to adopt strategies that are more selective rather than relying on across-the-board cuts and hiring freezes as the primary tools for handling cutbacks.

Another early need is to address labor costs. Partnering with labor unions through regular communication and open sharing of financial and other information from the beginning can contribute to cooperative problem-solving rather than confrontation. With



the potential tradeoffs between layoffs and giving up scheduled pay increases, union leaders and members may be willing to forego salary increases.

#### Take a long-term view

Cuts that focus on postponement of expenditures or one-time savings do not address structural issues in the budget. Cuts in recurring expenses in the first year carry over to future years. Many governments are responding to immediate pressures with 18, 24, or 36 month plans. Developing a longer-term fiscal strategy instead of simply balancing the current or proposed budget helps to identify the implications of current decisions. Managers should discourage the attitude that cuts are temporary and will be put back as they were before when conditions improve.

Organizations should invest in employee talent and information systems to strengthen financial forecasting. Long-term financial plans should be developed and continuously updated. It may be necessary to reexamine the logic and timing of a capital improvement plan if development patterns and pace are changing.

#### Focus on core mission, purpose, and highest priorities

Examination of programs and services should start with consideration of how central they are to the mission of the organization. Simon makes this focus the centerpiece of the county's response. "Employees, governing body members, and the public expect that the organization will have a clear and well-articulated core mission and purpose that will guide budget reductions, efficiency improvements, expenditure investments, and any revenue enhancements that may be considered." Tom Bonfield advises local government to "let go of lower priority programs in order to perform higher priority programs at the same level or even better." Once eliminated, the value of those lower priority programs becomes clearer. Are they really missed? In time, these programs can either be reinstated or their elimination can be confirmed. Priorities also guide tough personnel decisions. Bonfield observes that it is difficult to focus on the "people in particular positions rather than the priority of the work being performed."

#### Invest in innovation and continuous improvement

There are opportunities for true innovation in a cutback situation. Governments have adopted a wellness approach to increase individual responsibility for health promotion and reduce premiums. It is important to encourage staff to look to other organizations for good ideas and to expand staff capacity to innovate by improving systems and procedures, optimizing use of technology, reducing duplication, and accelerating the implementation of best practices. Cross-sectional teams can examine systems and working relationship and propose new approaches.



### Manage revenues as carefully as expenditures

It is important to ensure that all allowable revenues are fully collected, and that collections are timely, accurate, and fair. For example, officials in Fairfax, Virginia discovered that many companies were making errors on their tax forms and sending their sales tax collections to the wrong county. It is useful to link revenues to users where possible and equitable, through user charges and fees for service. Overhead costs should be fully captured in grant programs and from enterprise accounts. A task force of staff from across the organization in Phoenix has identified possible ways to expand revenue sources.

### Examine and improve organizational design and processes

Cutback periods call for a re-examination of the way the organization is designed including layers of management, combining departments, how services and functions are distributed, and centralization or de-centralization of administrative functions and support services. People and activities can be reorganized around common priorities, results, and shared customers, and departments and programs into can be realigned into business units that pursue common goals. Sarasota County has achieved substantial savings from moving all operations and maintenance equipment and staff into single “rental agency” that contracts out services to other departments (Webinar 2008). Achieving savings need not focus on budget cuts alone. Montgomery, Ohio recently used process improvement to offset a major road salt shortage in the Midwest. Service and safety was not sacrificed but a scarce resource was used better by education and involvement of the “guys that drive the trucks” in coming up with the solution.

### Foster stewardship and strengthen commitment to cost containment

Involve staff in identifying, implementing and rewarding ideas and actions that conserve energy and water, reduce the use of supplies, reduce waste, and streamline workflow. Link these efforts to the emerging emphasis on sustainability and conservation of resources. Make work in government a “team sport,” as Clearwater City Manager Bill Horne has suggested, and invite competition for ideas that save money (Webinar 2008). Reinforce the incentive to reduce costs by permitting departments to retain part of the savings, although the percentage may have to be lower in a cutback period than at other times. Publicly recognize employee ideas that improve service and reduce cost. To Katy Simon, the leaders should set the example that conservation is everyone’s responsibility and lead by declining pay and benefits that employees are asked to give up. Furthermore, administrators and elected officials should communicate to citizens their responsibility to help hold down cost of government.

### Create a workable schedule and stick with it.

The schedule should identify key decision dates and action dates. A sense of inevitability brings comfort during uncertainty. At the same time, there is a need for flexibility and adjustment as conditions change.

#### Develop partnerships

Options can be explored for greater cooperation and sharing with other organizations and service providers. Fretwell suggests that “sharing of services can be as simple as coordinating street cuts among differing utility providers, or as complex as completely consolidating governments or functions within governments.” Outsourcing arrangements should be reexamined to determine whether services should be contracted out or brought back into the local government. Opportunities for sharing service deliver with private sector, other public agencies, not-for-profit organizations, and coalitions should be examined.

In sum, city and county managers are called upon to take responsibility for addressing the challenges of economic downturn. They empower and support elected officials, engage the staff of the organization in meeting the needs of the fiscal crisis, and inform and involve residents of the community. Changes that are forced by circumstances are made in a proactive way, and leaders look for opportunities to make constructive changes and innovate in the face of adversity.

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In addition, the paper incorporates personal communications by email with Thomas Bonfield (1/20/09) and Cheryl Hilvert (1/21/09).