

SUSTAINABLE PUBLIC SERVICE ORGANISATIONS: A PUBLIC SERVICE-DOMINANT APPROACH

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This paper argues that the ‘New Public Management’ paradigm for public management theory and practice that has prevailed for the last thirty years is both flawed in theory and has failed in practice. We argue for an alternative to this paradigm that is rooted with the New Public Governance approach and that makes a reality of the Public Service-Dominant Logic for sustainable public services. We derive seven propositions for sustainable business practice for public services organisations from this approach.

Keywords: Public services, sustainable delivery, public service-dominant logic

JEL-Codes: Z18, H40, H75

1. INTRODUCTION

The current global economic recession presents significant challenges to public service organisations (PSOs) that deliver public services to local communities – whether these organisations are situated in the public, private or third sectors. Governments around the world have responded to this recession by a range of strategies intended to reduce public spending and generate growth. This is not the place to debate such strategies – that task has been undertaken by other writers (e.g. Kickert 2012). The general rubric of such strategies, however, has been ‘doing more with less’ (Patterson et al. 2009).

The public service delivery environment has consequently become a challenging one for PSOs, with a range of survival strategies, such as de-marketing (Osborne – Kinder 2011) and lean (Radnor – Osborne 2013) being considered by

these organisations. As a result of these pressures, and as argued recently by these authors in a short commentary paper (Osborne et al. 2014), there is a growing need to establish the basis for a sustainable business model for PSOs that will allow them to survive this recession and provide the basis for sustainable growth in the longer term. This paper develops what the basis of such a model might be. Building upon the call of Ashworth et al. (2013) for more theoretical critique and development of public management theory, the central argument of the paper is that the premises that underlie much contemporary public management theory, in its guise as the New Public Management (NPM), are flawed and not fit for purpose. Far from creating the basis for sustainable PSOs this body of theory has actually undermined their sustainability by encouraging a short term, transactional approach to the delivery of public services. We offer an alternative to this, based within the public service-dominant framework for public services delivery (Osborne et al. 2013). We argue that it is essential for PSOs to move beyond the failed transactional approach of the NPM and take a relational and public service-dominant approach that emphasises three elements: building relationships across the public service delivery system, understanding that sustainability derives from the transformation of user knowledge and professional understanding of the public service delivery process and being predicated upon the inalienable co-production of public services with service users.

Consequently this paper is in three parts. The first part tracks briefly the development of public management theory over the past two decades, from the NPM and towards the 'New Public Governance' (NPG) as the dominant paradigm of public services delivery. It both highlights the flaws in the NPM and the challenges that the NPG offers for PSOs. It will emphasise how the new environment requires that PSOs take a service-dominant rather than product-dominant approach to public services delivery. Based upon this analysis, the second part of the paper will then offer the basis of a sustainable business model for PSOs and derive a series of propositions from this model. The final part of the paper will highlight its contribution and implications for theory and practice, and will suggest a research agenda to take forward this sustainable business model for PSOs.

It is important to emphasise that this paper is a conceptual and theoretical one, though it does include some exemplar cameos of unsustainable and sustainable business practice by PSOs. However these are illustrations rather than empirical evidence and are used to demonstrate the implications of a public-service dominant business model for PSOs. The research agenda at the end of this paper details the research needed in the future to empirically test, validate and develop the model proposed.

2. FROM THE *NEW PUBLIC MANAGEMENT* TO THE *NEW PUBLIC GOVERNANCE*

The elements, genesis and history of the NPM have been well analysed elsewhere (for example, Hood 1991; McLaughlin et al. 2002; Thomas 2012; Osborne et al. 2013). In the US, an early attempt to respond to these critiques was contained within the *New Public Administration* movement (LaPorte 1971) – though this movement itself was criticised both for unnecessary federal interference in local public services (Cupps 1977) and for failing to result in a significant increase in citizen engagement in the public policy process (Walters et al. 2000). Consequently, the NPM movement argued for a more managerial and market-oriented framework for public services delivery and for one that did not simply reform the role of citizens and public administrators but which sought to recast them entirely.

The classic formulation of the NPM was encapsulated in Hood's seminal paper. The key elements of this approach included a consciously managerial, as opposed to administrative or professional, approach to public services delivery, a disaggregation of services to their basic units and a consequent focus on their discrete unit costs, a pre-occupation with performance management and output control, the growth of the use of markets and competition as a means to allocate resources (and a subsequent reformulation of citizens as public service 'customers'), and a special attention to the lessons from private sector management for the delivery of public services (Hood 1991).

This influential paper, and others, led subsequently to important debates both about the appropriateness of the managerial, as opposed to administrative and/or professional, model for public services delivery and about its impact upon this delivery (*inter alia*, Hood – Jackson 1991; Kickert 1997; Lynn 1998; Pollitt – Bouckaert 2004; Bingham et al. 2005). Whilst some of these critiques focused upon a comparative evaluation of managerial as opposed to administrative models for delivery public services, others argued against the basic premise of the suitability of the market as a mechanism for the allocation of public resources (for example, Schachter 1997). This latter argument built upon an earlier and on-going discussion about the comparable nature of private and public sector management: are they indeed, to use the classic formulation of Allison, 'alike in all unimportant aspects' (Allison 1983; see also Ring – Perry 1985).

This present paper poses a rather different critique of the NPM. Based upon ideas developed by several of its authors elsewhere (Osborne et al. 2013), it argues that the failure of the NPM derives from several directions. First, society has been transformed profoundly since the early inception of the NPM in the 1980s and the early 1990s. On the one hand, it has become more fragmented and it has become increasingly difficult, if not impossible, for single PSOs to respond in isolation to

social and economic needs (Haveri 2007) – if indeed this was ever possible. On the other hand the past two decades have seen the evolution of plural and pluralist systems of delivering public services. Government no longer acts as a single agent in delivering public services – rather it requires the collaboration of a range of actors across public service delivery systems. This development has been labelled elsewhere as the ‘hollow state’ (Milward – Provan 2000).

This evolving environment for PSOs has been described and analysed by others as the New Public Governance (NPG) (Osborne 2010; Morgan – Cook 2014). In contrast to the NPM, the NPG poses a set of emergent challenges for PSOs.¹ The first is to recognise and embrace the plural (in terms of a multiplicity of actors in delivering public services) and pluralist (in terms of a multiplicity of processes through which these actors interact with service users and citizens) nature of contemporary public services delivery – PSOs can no longer act as if their efficiency, effectiveness and sustainability were in their own hands alone. All too often, NPM-style reforms have concentrated upon internal efficiency alone rather than being externally focused upon effectiveness in meeting the expressed needs of service users and citizens. A good example of such failure has been in the implementation of ‘lean’ reform initiatives in public services (Radnor et al. 2012) which have led to internally efficient but permanently failing PSOs. In reality PSOs are now part of complex public service delivery systems where their mission-critical objectives require the successful negotiation of relationships within these systems – with policy makers, other PSOs, service users, citizens, and indeed a range of service system elements and stakeholders.

Significantly the NPG perspective goes beyond the network governance approach that has been articulated by, amongst others, Kickert (1997) and Klijn (2008). These latter approaches acknowledge that individual PSOs can no longer act in isolation and that they require a focus upon inter-organisational policy and implementation networks (comprising a multiplicity of PSOs) to properly understand the delivery of public services. However, the thrust of the NPG is that such an inter-organisational perspective is necessary but not sufficient. Drawing upon services theory (e.g. Gronroos 2007) it conceptualises public services not as what is produced within inter-organisational networks alone but rather as produced within public service systems that include PSOs themselves, service users and other key stakeholders (such as families or carers), local communities, hard and soft technologies and physical capital and products. It is the interaction of these complex service systems that is the core to effective public service delivery not

¹ We re-iterate that this has not seen the vanquishing of the NPM as a paradigm or topic of analysis – witness the recent excellent collection by Christensen and Laegreid (2011) as evidence of that. But it has led to it losing its hegemony as the over-arching paradigm of public services delivery in a fragmented world.

simply the governance of networks of PSOs. Such a systemic approach positions the service users centrally as an element of the design and delivery of public services through their role as co-producers (Osborne – Strokosch 2013). The task is thus not simply the governance of networks of PSOs but the governance of these interactive and complex service systems.²

Second, the NPG paradigm argues that PSOs are not producing technically designed and manufactured products – but rather are delivering intangible services that require attention to the processes of service delivery and relationships with service users, and not simply to service design. Gronroos (1998) has identified this search for the ‘missing product’ as a common mistake of failing service firms and this is equally relevant to PSOs as they strive to develop sustainable business models for the twenty-first century.

Third, PSOs also need to recognise that the product-dominant basis of the NPM is counter-productive to their survival. It assumes that their sustainability is driven by a business equation where production and consumption are treated separately – the costs of the former can be reduced without affecting the latter. This might be the case for manufactured products, but it is certainly not the case for services, including public services. In this case reducing production costs directly affects the quality of their use/consumption – and this affects their longer term viability and sustainability (Normann 2000; Gronroos 2007). A key issue here is the role of staff in service delivery. For many service firms they are one of their most expensive costs. PSOs, in particular, have sought to limit unit costs by reducing staff costs (such as residential homes for elderly people employing less well trained staff or reducing staffing ratios). Service theory identifies this as a counter-productive approach, however. Reducing staff costs invariably reduces the quality of the service and this weakens the market position of a service firm. Rather, service firms need to invest in staffing to improve the quality of the service delivered, thus strengthening their market position and sustainability – what Normann (2000) calls the ‘virtuous circle’ for the profitability and sustainability of such firms.

Fourth, throughout both public administration and the NPM, the task of public service delivery has been conceptualised as something to be enacted by public service professionals and where the service user is largely passive in the process, whether considered as a ‘client’ or ‘customer’ of PSOs. There have of course been movements to bring the service user into a more active role in service delivery through ‘co-production’ into the service delivery process (an excellent summary of this literature is provided by Alford 2014). Important as these approaches are,

² An example of what such systems might look like and what elements they can contain is provided by Radnor et al. (2014) in the context of higher education in the UK.

they frequently mistake the nature of the public service delivery task. In reality it is impossible to deliver any service without an element of co-production (Xue – Harker 2003) – this is part of the very definition of a service. Consequently the task becomes not one of how to bring the user into co-production but rather how to engage actively with this already existing component of the public service delivery process in order both to improve the quality of existing services and to plan for future service delivery and innovation (Osborne – Strokosch 2013). It is important to be clear that this is different from the ‘consumerist’ movement that has dogged public services over recent decades. This movement sought to extract the ‘public service consumer’ from the overall service process and has been subject to strong critiques elsewhere (e.g. Powell et al. 2010). What is proposed here is rather to understand the totality of the public service production system and the complex iterative interactions between service users and public service staff that occur within it.

Finally, the NPM has not been able to respond to the challenges to traditional public services delivery of knowledge-driven services delivery within the digital economy. Not only is this transforming the nature of relationships between PSOs, politicians and service users, it is posing questions both of the achievement of public value as the indicator of public service effectiveness rather than internal measures of public service efficiency (e.g. Moore 2002; Bekkers et al. 2011; Benington – Moore 2010) and of the governance processes required to negotiate agreement about such effectiveness (e.g. Brown – Osborne 2013).

2.1. Interim conclusion

What has been remarkable in the early responses to the global recession by governments and PSOs alike is how rooted they have been in the tenets of the ‘old’ NPM and the belief that internal cost cutting and efficiency programmes will produce sustainable PSOs for the long term (or even the middle term, for that matter). Yet as argued above, this has failed to facilitate sustainable PSOs in time of growth and is doomed to fail in the current recession and beyond. The underlying question therefore is that of the nature of sustainable business practice for PSOs within this new reality. To, summarise, the challenges that this question leads to include the need

- to understand public services as the result of complex public service delivery systems rather than of either individual PSOs or inter-organisational networks of PSOs;
- to embrace public service delivery as being relational and process-based rather than transactional and product-based;

- to realise that the business logic of public services is, like for all services, different from that of manufactured goods;
- to develop reform strategies for public services that understand that reform requires a cultural change within PSOs away from a pre-occupation with internal efficiency alone and to an externally, end-user driven culture, predicated upon service effectiveness and the creation of public value;
- to acknowledge co-production as central to the realisation of effective public services rather than as a marginal or ‘add-on’ element, and
- to accept that digital technology is transforming the relationship between PSOs and service users, as it is for all service delivery.

In the next part of this paper we will sketch the elements of an alternative model of sustainable business practice for PSOs that embraces both the reality of the challenges that the NPG framework poses for them and the implications of a public service-dominant logic for public services delivery.

3. TOWARDS A SUSTAINABLE BUSINESS MODEL FOR PSOS: THREE UNDERLYING ASSUMPTIONS

Before addressing the central conundrum of this paper, of the nature of sustainable business practice for PSOs, three basic assumptions need to be addressed: what we mean by ‘public’ organizations, the nature of ‘sustainable’ business practice, and the nature and purpose of ‘a business model’.

The starting point for our analysis is Allison’s (1983) contention that *public agencies and private firms* that operate in commercial markets are indeed ‘unlike’ in all important aspects. As Ferlie (1996) argued, the NPM includes a set of ideological assumptions as well as prescriptions for managerial practice. *Inter alia*, these include the supremacy of managerial practice in the private sector over that in the public sector, the assumption of the hegemony of competitive markets as the most efficient allocative device for societal resources, and, as a consequence, the imperative for PSOs to mimic private sector practice in order to achieve sustainability as individual organisations through privatisation (e.g. Pirie 1988; for analysis of this ideological agenda of the NPM and its implications for PSOs see Ascher 1987).

Of course, at the heart of this debate there is a nugget of truth. For public services to be sustainable, individual PSOs must first be sustainable. However, as will be argued further below, the NPM took this truth and extrapolated it into a model that placed individual organisational survival and success above the creation of public value and the effective response to economic and social need. As

McLaughlin et al. (2009) have argued, in the British health service this led to the privileging of the business model of individual health providers above the overall health needs of the nation.

Our argument is that this has not proven a model either for sustainable business practice by PSOs (whether from the public, private or third sectors) or for the provision of sustainable public services. For firms in commercial markets, there is a comparatively straightforward, bottom line – the production of a profit for their shareholders and/or owners. This is sufficient to be sustainable in commercial markets. For PSOs, however, sustainability is a far more complex issue, as discussed further below. In striving for sustainability they need to resolve four substantive challenges. First, choice for PSOs is constrained. They can rarely, for example, choose their service users, their range of service offerings or their geographic locus. These decisions are taken for them and are dictated often by statute and legislation (Ring – Perry 1985). Second, they are also accountable for their business practice in providing public services through democratic mechanisms of accountability rather than through the market alone. These democratic mechanisms have certainly been stretched and eroded by the NPM but accountability to the citizen is nonetheless still a basic element of public, as opposed to private, services (Thomas 2012). Third, and implicit in the above, is that central governments have a role in creating the political and democratic context for PSOs and over which PSOs themselves have little, if any control (Benington 2011). Underlying all these challenges is a fundamental one of *the nature of sustainability for PSOs*. This issue is explored in more detail in Guthrie et al. (2010). We build on their argument to expand the notion of ‘sustainability’ across a number of key dimensions for PSOs:

- the sustainability of individual PSOs;
- the sustainability of public service delivery systems and their governance mechanisms;
- the sustainability of local communities, and
- environmental sustainability.

This requires PSOs to move beyond strategic planning, with a focus on individual survival, and towards a strategic orientation that is value based (Deshpande et al. 1993). This requires the development of a ‘business model’ for PSOs that is rooted in such an externally and value focused view of public services delivery.

A business model is a simplified representation of choices both about how an organisational entity, public or private, creates and distributes value amongst its stakeholders over time and how it ensures its own sustainability into the future (Zott et al. 2011). Business models are more than a simple descriptive narrative – they need to guide practical actions (Magretta 2002). Nor are they unchanging

recipes since successful business models will evolve with environments and opportunities: new combinations of external needs and possible solutions are constantly emerging and recombining as technology and the environment change (Baden-Fuller – Morgan 2010). Traditional business models in the private sector have been predicated upon the ‘single bottom line’ of organisational profitability as a measure of sustainability. However, as discussed above, this is an insufficient measure of sustainability for PSOs. Public service business models need to be more sophisticated.

Our approach moves beyond the narrow focus of traditional business models therefore. These traditional models, even with the more evolutionary and open orientation noted above, continue to be predicated upon a linear, product-dominant focus. However, recent authors have argued strongly that this approach is not ‘fit for purpose’ for modern businesses. Most significantly, Lusch and Vargo (2014) have argued robustly that contemporary business requires business models embedded within a service-dominant logic, because this logic, predicated upon knowledge transformation, is now the basis for value creation for any type of business. Bitner et al. (2000) have also argued that active customer engagement is now at the heart of effective business practice. This is the approach that has been followed here in our development of a sustainable business model for PSOs, based upon a *public-service dominant logic* (Osborne et al. 2013).

Towards a sustainable business model for PSOs. Thus far we have argued for embracing rather than minimising the complexity that PSOs face in achieving sustainability, as well as for clarifying what this might mean in the context of public service systems. We have argued for a value-based approach that emphasises the relationships, governance and negotiation that is epitomised within the NPG rather than the limited and failed focus of the NPM. At the heart of this is a public service-dominant business logic, as discussed above. To date, though, this business logic has been specified as a way to describe the ‘actually existing’ nature of public services. The intention here is to take a step further. On the basis of the public service-dominant model, we argue here for seven propositions to form the basis of sustainable business models for PSOs in the twenty-first century. These propositions are that

- public services are systems and not just organisations, or even inter-organisational networks, and need to be governed as such, embracing all of their elements (Radnor et al. 2014);
- individual PSOs need to be sustainable in their own right in the short term – but this is a necessary and not a sufficient condition for the long term sustainability of PSOs and of public service systems (Boozeman 2002, Grindle – Hilderbrand 1995);

- consequently, such internal efficiency is necessary for individual PSOs but will not produce sustainable public service systems; rather PSOs need to be outward-focused on external effectiveness for service users and on creating sustainable public value for local communities (Radnor – Osborne 2013, Vidal 2013);
- the key resource and route to effectiveness for PSOs is knowledge (both of professionals and of services users) and the key tools for its transformation into successful public services are relational rather than discrete and transactional – this transformation is currently emphasised and supported by the information generation, sharing and utilisation possibilities offered by social media and digital technology (Margetts 2009, Bekkers et al. 2011);

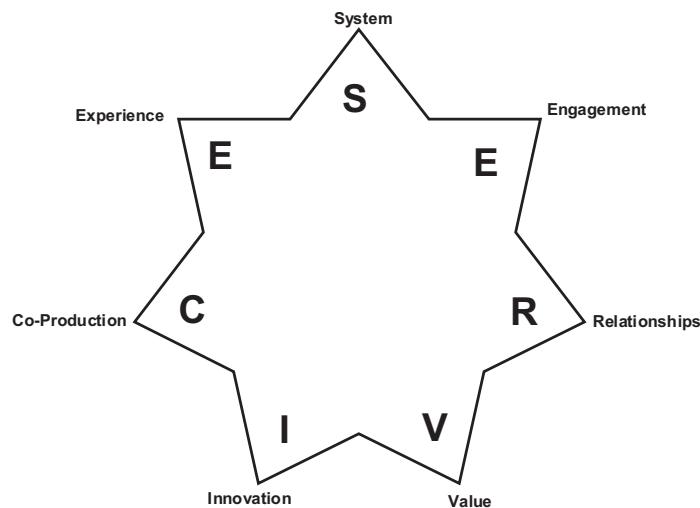


Figure 1. The seven-pointed 'SERVICE' star of a sustainable business model for public services organisations

- sustainable PSOs are dependent upon building long-term relationships across service systems rather than seeking short term discrete and transactional value (McLaughlin et al. 2009, McGuire 2012);
- co-production is at the heart of public services delivery and is the source both of effective performance and of innovation in public services (Osborne – Strokosch 2013), and
- public service systems need to embrace environmental sustainability also, if they are to be truly sustainable into the second half of the twenty-first century and beyond (Guthrie et al. 2010).

These propositions have been summarised through a ‘SERVICE’ star (Figure 1) which indicates the elements to develop a sustainable business model for public service organisations.

4. SEVEN ‘SERVICE’ PROPOSITIONS FOR A SUSTAINABLE BUSINESS MODEL FOR PSOS

Proposition 1: public services are Systems, not just organisations and need to be governed as such. The NPM was predicated upon the necessity of individual PSOs to compete in markets and quasi-markets (Le Grand 2007). This required them to clarify unit costs on a discrete and transactional basis and invariably ignored the transaction costs of such a business model – despite long-standing evidence in commercial markets of the impact of such ignorance (e.g. Dyer – Chu 2003).

This led to the development of models of for-profit sustainability predicated upon collaborative endeavour rather than simple competition (Best 1990, Phelps – Raines 2003). Public management responded to this critique of the NPM in the late twentieth century by exploring the efficacy of inter-organisational networks as an alternative to, or modified form of, the market model (Kickert 1997; Rhodes 1997; Provan – Milward 2001; Klijn 2008).

Whilst such approaches perhaps engaged more with the actuality of public services provision in the post-modern era (Haveri 2007), they nonetheless continued to mistake the nature of this provision as being something that was the domain of PSOs alone. However, a core tenet of the New Public Governance and a public service-dominant logic is that PSOs are only part of the systems that delivery public services. Other key elements include service users themselves, their families and significant others, local communities, and hard and soft technologies. Sustainable PSOs must therefore embrace these service systems and learn how they interact with their other elements in order both to be sustainable within these systems and to contribute to sustainable service systems also. Technologies for such systemic and process-oriented business models do exist – notably service blue-printing (e.g. Shostack 1982; Lovelock – Wirtz 2006). They have begun to be applied to public services delivery in discrete areas, such as higher education (Baranova et al. 2010; Radnor et al. 2014). However their potential for contributing to sustainable PSOs and sustainable public services is yet to be fully realised. This approach is the cornerstone of our model of sustainable business practice for public services.

Proposition 2: PSOs need to Engage in organisational sustainability in their own right in the short term – this is a necessary but not a sufficient condition for long term sustainability. The kernel of truth at the heart of the NPM was that PSOs have to address the issue of organisational sustainability if they are to continue to contribute to public service systems (and maintain their employment of staff and managers, needless to say). The flaw in the NPM reasoning was then to suppose that such sustainability derived from creating PSOs as individual service ‘silos’ responsible for their own costs and in rivalrous competition with all other PSOs. However such a model had long been out of favour as ‘best practice’ within commercial markets due to the fact organisations operate within systems as we have argued in proposition 1. Not only were its transaction costs prohibitive, it also made the sharing of risk in relation to innovation problematic (Best 1990). As the flaws of the NPM became apparent, in Europe at least, public policy and PSO managers turned to alternative strategies. One popular approach has been the move towards ‘social entrepreneurship’ and ‘social enterprise’ as conduits to sustainability – the idea being that PSOs should concentrate upon creating sustainable flows of real income rather than being reliant upon government grant income (Sullivan Mort et al. 2003; Galera – Borzaga 2009). The approach has been problematic for a range of reasons. At one level, this debate has been one of trying to ‘recreate’ (or maybe re-brand) the wheel – the approach is not new, as many PSOs have been seeking such sustainable income streams for decades. There has also been disagreement as to what these terms means, as well as disagreement as to their implementation. A terminal failing has been to concentrate upon them as an end in themselves rather than as a means, as recent studies (Osborne 2012; Vidal, 2013) have revealed, It is not organisational form or entrepreneurship ‘per se’ that creates sustainability but the adoption and engagement with a sustainable business model rooted in a public service dominant-logic. Thus these recent studies found examples of social enterprises that were successes and failures. Where they succeeded it was because they adopted a long-term approach to building and sustaining relationships and where they failed it was because they sought to handle these relationships in a transactional manner. This latter approach could work in the short-term it was found, but undermined the willingness of other elements of the service system to work with such PSOs in the longer term, hence undermining their long-term sustainability. A basic element of a sustainable business logic for PSOs, therefore is to understand that organisational sustainability is a precursor to all else – but that this flows from understanding and engages in the relational nature of public service systems and seeking to govern all its elements rather than seeking sustainability in isolation. This is a chimera in the topography of contemporary public service systems.

Proposition 3: sustainable PSOs are dependent upon building long-term Relationships across service systems rather than seeking short term transactional value. One of the failures of public services marketing, as it has evolved over past four decades, has been for it to become situated a tool of the ‘marketisation’ of public services as part of NPM-style agendas, rather than as a desirable management discipline in its own right (Walsh 1994; Burton 1999). In doing so it has neglected the opportunities offered by alternative conceptualizations of marketing that take institutions and networks, rather than discrete transactions, as the central unit of analysis (Laing 2003). Osborne et al. (2009) have argued that public services marketing practice has been dominated by precisely such transactional models of marketing that have belied the relational complexity of public service systems and has hence contributed to their lack of sustainability. There has also been a consequent failure to explore alternative approaches to marketing that might offer a route to genuine sustainability by identifying and facilitating the enduring relationships that are essential to sustainable public services (Erridge – Greer 2002; Schwartz 2005; Bovaird 2006).

The genesis of public services marketed is generally credited to the work of Philip Kotler (*inter alia*, Kotler – Levy 1969; Kotler – Andreason 1975). Crucially, Kotler’s ideas about public services marketing were rooted in classical economics and a model of exchange theory that supported a purely transactional view of marketing, with the PSO as a discrete entity operating in isolation from other organizations. This transactional view of marketing was based upon a model of market transactions that have ‘a distinct beginning, short duration and sharp ending by performance’ (Morgan – Hunt 1994: 1). As discussed above, this position has been criticized latterly in the broad management literature, through the concepts of the ‘new competition’ (Best 1990) and ‘new institutionalism’ (Powell – DiMaggio 1991). Drawing upon the work of Benson (1975) on resource-dependency theory and Williamson (1985) on transaction cost analysis these approaches posit the need for collaboration in order for PSOs to lever in the information, resources and capabilities necessary for sustainability. Such a model introduces new levels of complexity to exchange relationships that Osborne et al. (2009) have argued are beyond the scope and competencies of traditional transactional models of marketing. The alternative, they contended, is to embrace the service-dominant model of relationship marketing.

Relationship marketing (RM) acknowledges that sustainable competitive advantage increasingly requires collaborative activity rather than rivalrous competition, and that relationships are often the most valuable resource of an organisation, public or private (Helfert et al. 2002; Veloutsou et al. 2002). Harker (1999: 16) has defined RM as an organization engaging in ‘...proactively creating, de-

veloping, and maintaining committed, interactive and profitable exchanges with selected customers over time'. The core of such relationship building is *trust*.

Trust thus is at the core of RM and both facilitates the adaptation process that is often necessary to complete an exchange within an on-going relationship (Brennan – Turnbull 1999) and provides the basis for mutual commitment that 'reduces the uncertainties associated with opportunistic behaviour' in a volatile environment or market (Sheth et al. 2000). Given the enduring emphasis in public policy upon trust as a governance mechanism within the plural state (Davis – Walker 1997; Osborne 2006), it is surprising therefore that RM has not yet made a significant contribution to marketing practice within PSOs. As argued above, the governance of external-oriented relationships (with other PSOs, service users and other key stakeholders in the public service system) is at the heart of a sustainable business model for PSOs. RM offers a robust framework by which to fashion and guide – and when necessary terminate (Gulati et al. 2000), such relationships.

This contribution is enriched further by allying it with the associated concept of 'relational capital'. Kale et al. (2000: 218, emphasis added) define this as '... the level of mutual trust, respect and friendship that arises out of close interaction *at the individual level* between alliance partners.' The key contribution for PSO managers here is to focus upon the import of *individuals and individual relationships*. Too often it seems that, in the public administration and management field, relationships are reified to the organizational level – the neo-corporatist assumptions of the now defunct Voluntary Sector Compact in the UK are a good example of this (Osborne – McLaughlin 2002). A focus on relational capital makes explicit that the key to effective relationship management is to locate them at the individual level, where the staff of a PSO interact with policy makers, the staff of other PSOs and service users. Such an approach is essential to building a sustainable business logic for PSOs.

Proposition 4: internal efficiency is necessary but not sufficient for sustainable PSOs – it needs to have an outward not inward-facing focus on Value. Perhaps one of the most enduring example of the failure of the NPM has been that of the application of 'lean' approaches to reforming and improving public services delivery (Radnor – Walley 2008). Lean seeks to 'design out' inconsistency and waste in the operational processes of service delivery. It is predicated upon the need to design these processes to produce maximum value for their end-users and to lead to sustainable service businesses by shifting the organisational culture towards one of continuous improvement predicated upon such (external) end-user value (Womack – Jones 1996; Holweg 2007).

In the last decade such approaches have been seen in both the US and the UK as a panacea for poor public service performance. Indeed, their early implementation

did lead to significant improvements in the efficiency of public services delivery in a range of areas including local government, the health service and national government functions (e.g. Barraza et al. 2009; Radnor 2010). However, such efficiency gains did not prove to be sustainable in the longer term. There were two reasons for this (Radnor – Osborne 2013). First these savings came primarily from lean addressing prior design faults in PSOs rather than addressing longer term sustainability issues. Once these ‘low hanging fruit’ had gone, though, lean proved incapable of addressing the more fundamental question of a sustainable business model. Second, and most relevant here, the application of lean within PSOs mistook the nature of end-user value. It has universally taken an inward-focused approach upon *internal* users and user value, rather than *externally* focused. To put it simply, such an approach is able to create more efficient PSOs (by improving internal efficiency) but fails to address public service effectiveness because it does not orient itself to user-value as expressed by its external end-users – the users of public services. Bluntly it is a recipe for creating very efficient but *permanently failing* PSOs (Meyer – Zucker 1989; Jas – Skelcher 2005).

This does not have to be the extent of lean though. In its original guise, as the Toyota Production System, lean was an approach to adding value to the external end-users. Such an external orientation is a vital component of a sustainable business model for PSOs. It is essential to enhance and make sense of internal efficiency and to address organisational sustainability. But this only produces long term sustainability, for PSOs and public service systems, when it is predicated upon an external focus that is about adding value to the external end-users of public services.³

Proposition 5: business growth for PSOs is predicated upon Innovation – not as a means to achieve competitive advantage but rather as means through which to achieve service efficiency and effectiveness. The NPM did acknowledge innovation as essential to sustainability in public services. However its model was derived from product-dominant approaches to innovation that situated it as a driver for competitive advantage in competitive commercial markets (for example, Porter 1985). Increasingly though, the for-profit sector has come to the view open, collaborative, innovation as a more effective route to commercial sustainability. Not only does it share the costs and risks of innovation, it also combines the resources and knowledge of different firms to enhance innovative potential (for example, Chesbrough 2003; Von Hippel 2006).

³ Such an insight is not new in organisation theory of course. It was raised by, amongst others, Miles and Snow (1978) and Burns and Stalker (1961) in their seminal but enduring studies of organisational strategy and organisational innovation respectively. Unfortunately such insights have become obscured in public management over the past three decades of NPM.

For PSOs innovation is a further element of a sustainable business model and goes to the heart of a public service-dominant business logic. It puts the expressed needs of service users at the heart of the public service system and orients PSOs to be externally focused upon these needs rather than internally focused on efficiency alone.⁴ Value (as stated in proposition 4) needs to be viewed on the external rather internal needs.

Once more drawing upon the services management literature we would argue that for innovation to contribute to sustainable PSOs and public service systems it needs to break free of the product-dominant constraints that have inhibited its contribution to such sustainability in the past (Osborne – Brown 2011). There are three conditions for this. First, as already articulated it needs to be externally focused to add value to the lives of service users rather than focused on internal efficiency (alone). Second the service user and co-production are required to be at the heart of the process if innovation is to be genuinely oriented to service effectiveness. Finally, governance rather than management is the essence of innovation. To take but one example, Brown and Osborne (2013) have illustrated how a governance approach to risk is essential to innovation in public services, that requires the negotiation of innovations across complex service systems and that makes explicit the costs and benefits of any innovation as well as where these might lie (see Kinder 2000 for an example of the impact of the avoidance of such risk governance on innovation in public services). Innovation is an inherently risky process – the majority of innovations fail as the evidence demonstrates (Klein – Sorra 1996). If it is to contribute to sustainable business logic for public services then an explicit engagement with these risks and their governance is essential. If such a proactive process is engaged in, innovation offers a pro-active element of sustainable PSOs. This can be through their continuous development and improvement (incremental innovation), the development of new services complimentary to those that a PSO currently offers (evolutionary innovation), the geographic or industry-expansion of existing services to new groups of service users (expansionary innovation), and the creation of genuinely new forms of public services that address newly identified needs in novel ways (total innovation) (Osborne – Brown 2011).

Proposition 6: Co-production is the source both of effective performance and of innovation in public services. As discussed earlier, there is a substantial literature within the public management literature concerned with ‘co-production’ in the

⁴ To reiterate, this is not to say that efficiency is unimportant. It is necessary, indeed vital, for sustainable PSOs. But without a public service-dominant business logic that is externally and user oriented, it offers only the prospect of efficient, but permanently failing PSOs.

implementation of public policy and the design and delivery of public services. Whilst this literature includes a continuum of perspectives on co-production, it has often set the co-production of public services apart as a variation on the ‘usual’ model of public service delivery where “public officials are exclusively charged with responsibility for designing and providing services to citizens, who in turn *only* demand, consume and evaluate them” (Pestoff 2006: 506; emphasis added). Thus it discusses the ways in which user involvement can be ‘added into’ the operational process of service delivery.

Such an understanding of co-production, we would argue, is derived from product-dominant logic where production and consumption are separated as discrete processes – thus public services are conceptualized as products to be designed and produced by public policy makers and service professionals and consumed (relatively) passively by service users. Co-production can only occur at the behest of, and controlled by, service professionals. However, a central tenet of the public service-dominant logic is that co-production is an unavoidable element of public services delivery and central to a sustainable business model for PSOs.

We would further argue that the current debate upon co-production in the public management literature is based upon a partial and mistaken view of co-production, as something to be added into to ‘traditional’ public service delivery for distinct ends. In contrast, a public service-dominant approach offers a very different perspective. In this reading, co-production is a core element of any public service delivery system. It is an essential and intrinsic process of interaction between any service organization and its service users at the point of delivery of a service (Gummeson 2007). From a public service-dominant approach, therefore, there is no way to avoid the co-production of public services. The question thus is not how to ‘add-in’ co-production to public services but rather how to actively engage and work with it in order to ensure sustainable PSOs and public service systems (Osborne – Strokosch 2013).

Normann (2000) has encapsulated co-production as ‘the moment of truth’ of services delivery. Service organisations can only ‘promise’ a certain process or experience – the actuality is dependent upon such co-production. A classic example of this would be the co-produced experience of residential care by the interaction of staff and service users in a residential home for the elderly. The managers of this home may have a vision of what care they want to provide, but the actuality of it is enacted in the iterative interactions between service staff and service users.

In reality, of course, such co-production of public services is rather a continuum than a steady state. Public services such as residential care and education are clearly instances where it is high, owing to the fact that consumption and production take place at the same point in time and with direct face to face contact between the service user and the service provider (in the care home or the classroom,

respectively). By contrast, they are rather lower for electronic public services (such as paying your local taxes through a web portal) that do not have the inter-personal immediacy of face-to-face contact between the service provider and the service user.

Conceptualising co-production as a core element of sustainable public services reframes our understanding both of the service delivery process and of the role of public management in achieving such sustainability. To take just one issue, a public service-dominant approach to innovation in public services puts the service user rather than the policy maker or professional at the heart of this process (e.g. Gallouj 2002) and has profound implications for the management of the process as stated in proposition 5 – such as in terms of how public service innovations are derived and how risk is governed in the innovation process (Osborne – Brown 2011; Brown – Osborne 2013). A core element of a public service-dominant approach to the co-production of innovation also relates to our proposition # 7. This is its potential to unlock the tacit or ‘sticky’ knowledge that service users possess in order to improve existing or develop new services (Von Hippel 1994; 2006). Here, a PSO proactively seeks to uncover, understand and satisfy ‘latent (or future) needs’, rather than simply reacting to existing or currently expressed needs – as has invariably been the case with public services. The services management literature has highlighted a range of ways in which such service user co-production of innovation can be achieved (for example, Alam 2006) as well as highlighting some of its drawbacks and dangers (such as over-customisation and its consequent financial implications).

Co-production then is a further element essential to a sustainable business model for PSOs. It puts the service user at the heart of the public service delivery system to maximise the value added to their lives, embraces the nature of public services as ‘services’ rather than products, with all its concomitants for sustainability, and harnesses their knowledge to improve existing public services and innovate new and more effective services,

Proposition 7: a key resource for PSOs is Knowledge and using it for delivering service experience. Two of the most common truisms about services management are that; service performance is created when service user expectations collide with the reality of their service experience and, that service delivery is about the transformation of knowledge into such a service experience through the process of service delivery (Gronroos 2007). This is as true for public services as it is for other services. Despite this, public policy makers and public service managers have persisted in the search for product-design routes to sustainability – through the iterative restructuring of PSOs or through a focus on the technical specification of public services, in terms of professional roles, rather than upon this

transformational process that adds value to the end-users of public services. This is a pernicious variant of what Gronroos (1998) has previously called the search for the missing product in service delivery – a focus upon the technical specification of a service ‘product’ rather than upon the knowledge transformation process that contributes value to end-users.

For public services the sources of such knowledge are numerous – *the technical knowledge* of public service professionals, *the ‘sticky knowledge’* (Von Hippel 1994) of service users, and *the contextual knowledge* of other key stakeholders in the public service delivery system (such as carers, family members, and members of the local community). A sustainable business model of PSOs has to focus upon how to capture these varying forms of knowledge, weigh them against each other and transform them into service outcomes for their end users. This task has been made both easier and more complex by the advent of digital technology. This offers the promise of greater access to a wider range of knowledge sources – but such access also offers a challenge in terms of sifting and weighing these information sources against each other (Dunleavy et al. 2006).

Elsewhere, Lusch and Vargo (2006, 2014) have argued that such transformation of knowledge is actually the defining feature of a sustainable business model in any market, public or private, product or service based. A sustainable business model is thus not concerned with the control of the unit costs and internal efficiencies of a production process, as conceptualised in the NPM, but rather with ‘the application of specialized skills’ and where ‘knowledge is the fundamental [resource]’. In this process the service user is always the co-producer of value in that there is no extant value for a service until it is used – ‘experience and perception are essential to [service] value determination’ (Lusch – Vargo 2006: 44). A public service-dominant model of sustainable business practice is thus one that places the utilisation and transformation of specialized knowledge and skills at the heart of service delivery to achieve service experience rather than the specification of units of output and their associated costs.

5. CONCLUSIONS: TOWARDS SUSTAINABLE PSOS AND SUSTAINABLE PUBLIC SERVICE SYSTEMS

This paper has argued for a public service-dominant approach to delivering public services as the only route to long term sustainable PSOs and sustainable public services. It has argued that the NPM, whilst containing important insights, was a flawed model and has failed in implementation, for two reasons. First it sought to impose a product-dominant logic onto public services rather than understanding the fundamental differences between product and services management. This is

its fatal flaw. Second, it has been unable to come to terms over the last decade with the emerging dominant paradigm of public services delivery – New Public Governance (NPG) (Osborne 2010) which has recognised that public services delivery requires the governance of sophisticated public service systems rather than individual PSOs. As an alternative we have argued that a sustainable business model both for PSOs and for public service systems within the NPG requires an approach that embraces their public service-dominant nature. Subsequently we have developed this argument into seven propositions to support a sustainable business model for PSOs and for public service systems. These are shown diagrammatically in Figure 1 in our ‘seven pointed ‘SERVICE’ star of a sustainable business model’ for public service organisations. This business model now requires further empirical testing to refine its components, test out their limitations and exceptions and to develop metrics to evaluate their impact. Key initial areas for empirical testing include:

- the explication in more detail of what a sustainable PSO and sustainable public service are;
- the inter-relationship between the above propositions and their dynamic interaction;
- the dimensions of public value as a metric of sustainability and the development of other useable metrics, and
- the dynamics of the relationship between internal efficiency and external effectiveness for PSOs.

We would close with three areas requiring critical attention. First, our argument has already alluded to the development of ICT and digital technology. As for services in general (Surjadjaja et al. 2003; Ghosh et al. 2004), this poses important challenges to sustainable PSOs and sustainable public services, by challenging their very nature. Most public services have traditionally been based upon Normann’s ‘moment of truth’ where service providers and service users interact in real-time. Increasingly though such moments of truth are becoming virtual and mediated by digital technology. Work has begun upon exploring the implications of this seismic innovation for public services (for example Margetts 2009). The implications of this work for sustainable PSOs and public services urgently need to be considered.

Second it would be sophistry in the extreme to characterise all public services as part of a homogenous whole. Inevitably there are differences between public services in different service sectors or at different points of the public service delivery chain. Whilst we would argue that the principles of sustainability identified here are germane to all PSOs and public services, their actuality and import will

vary. The contingencies of such variation need to be identified and explored to deepen our understanding of truly sustainable public services.

Finally, in addressing the practical challenges of making a reality of public service-dominant sustainability it is not necessary to reinvent the wheel. Key knowledge does exist on such topics as working with stakeholders across public service systems (Bryson 2004; Crosby – Bryson 2005), upon externally focused strategic planning and management for PSOs (Stone 2010), inter-organisational network governance (Klijn – Koppenjan 2000), and upon risk governance for public services (Brown – Osborne 2013). This knowledge requires to be harnessed to underpinning an effective approach to a public service-dominant sustainable business model for PSOs and public services. Research attention can then be focused upon the under-researched and under-theorised topics identified above. This is an essential task for the development of public management theory that is fit for purpose in the twenty-first century.

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