

Program design for continuous improvement in human services: a case study of Australia's disability employment sector:

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Contractually based purchaser-provider relationships have been adopted in a variety of human services settings in recent years. These programs have been extensively promoted by both federal and state governments. Two rationales have been offered. First, governments need to control ballooning welfare and human service budgets and they claim that this outcome is best achieved through appropriately designed competitive architectures. Second, proponents of contractual approaches argue that such arrangements will also drive continuous improvement in services for clients (Andrews, 2005). This has typically involved the introduction of a rolling performance target or some analogous mechanism (e.g. the Star Ratings system in the job network). In reconciling the apparently contrary objectives of cost control and continuous improvement, purchaser-provider architectures promise to satisfy simultaneously taxpayers, service providers and clients.

The theoretical genesis of this approach lies in agency theory and in more general neo classical modelling of market dynamics and impacts. The extraordinary influence of these theories is evident in the widespread adoption of purchaser-provider architectures in a variety of public policy domains, ranging across health, education, employment and community services (Smith, 2007). In exploring the likelihood that both cost control and continuous improvement are best pursued through quasi-markets, this present paper addresses three issues. First, are agency theory and market models the only relevant theoretical frame? Second, in any particular human services setting, what specific *empirical* or contextual analysis is needed to design effective policy frameworks? And third, what has been the experience in particular settings when competitive purchaser-provider architectures have been introduced (e.g. in relation to outcomes, transaction costs and continuous improvement)? Here evidence is drawn from experience in the Job network.

The conclusions of this paper can be summarised in two propositions. First, present purchaser-provider policy designs are inadequately grounded in theory. Second, in practice, they have realised perverse outcomes. Human service designs that are shaped by agency and market theory alone are likely to realise cost economies - but at the expense of difficult to serve clients. Further, they are likely to positively hinder continuous performance improvement. If continuous improvement is the goal, the case for supplementing present approaches is overwhelming. Considerations beyond those recognised by agency and neo-classical theory are pertinent. Above all, the knowledge system in any particular human services setting needs to be mapped. This assessment then needs to be reflected in the architecture of purchaser-provider relations. The design must be congruent with at least three conditions: first, problematic or critical processes or circumstances need to be routinely identified (e.g. key processes; clients or categories of clients who present special difficulties); second, knowledge that might solve these difficulties or enhance key processes needs to be routinely generated; third, this knowledge needs to be routinely and rapidly disseminated amongst those who need to know. These are the essential requirements for continuous improvement. There is also no single knowledge architecture that is appropriate in all human services settings. The particular circumstances of each setting need to be taken into account. These findings have very wide implications for policy designs in all human services contexts. .

The paper is organised in three sections. The first section explores the alternative theories that might be relevant to policy design. Based on a survey of service providers, the second section maps the knowledge system in the disability employment sector. The third section looks at actual experience with a purchaser-provider structure, this time in the broader Job Network. The final section assesses the evidence concerning the efficacy of present policy designs and introduces an alternative approach that might better reconcile cost management and continuous service improvement.

I. Theories about Innovation and Continuous Improvement:

Frameworks derived from neo-classical economic theory have been particularly influential in framing purchaser-provider policy design (Boston et al, 1996; Miller,

2005). Agency theory is one important source of design principles (Boston, 1996, p. 32-33; Meir and Hill, 2005). To obviate shirking, opportunism, information asymmetries etc in purchaser-provider settings, advocates claimed relationships should be based on a quasi-market, contractual form, with penalties for poor performance. This framework seeks to control costs whilst also driving continuous performance improvement. This latter goal can be achieved by various means. That introduced to the Job network involved a rolling performance benchmark, the Star ratings System. This centrally determined adjustable target is based on actual outcomes. The target is adjusted in line with the outcomes achieved by the 'best' performers. This is naturally a very complex determination with appropriate adjustments for differently constructed case loads etc. But the dynamics are straightforward. Operators who fall below designated performance norms have their contracts modified or withdrawn.

More recent theoretical work has qualified significantly the expectation that unfettered competition alone is likely to drive innovation and continuous performance improvement. Starting from the early 1980s, the role of knowledge as a driver of performance and productivity has come increasingly into focus (e.g. Nelson and Winter, 1982; Dosi et al, 1988; von Hippel, 1988; Porter, 1990; Lipsey et al, 2005). This has developed particularly in business and commercial contexts. It has concerned flows of knowledge from science and research laboratories to products and services and the development of knowledge based capabilities in particular sectors (e.g. on the Australian wine industry, Smith and Marsh, 2007). The broad findings of innovation theory can be transposed to any domain where continuous improvement is the goal, including public policy and human services settings. Jonathan West (2006) has summarised the key lessons of innovation literatures:

‘Some essential components of an effective innovation system cannot be developed by private firms alone. Research to identify characteristics of innovative firms highlights several typical features, each of which appear to relate to enabling factors in innovation:

- **Innovating firms are collaborators.** Knowledge creation takes place through interaction with other enterprises, organisations, and public institutions of the science and technology infrastructure. Indeed, empirical research has shown that innovating firms are almost *invariably* collaborating companies, that collaboration persists over sustained periods,

and that universities and research institutes are important collaboration partners.¹

- **Innovating firms accumulate capability over time.** Past developments tend to be utilised to determine future pathways of innovation. Cumulative capability acquisition underlies patterns of specialisation in economies, and creates differentiation among regional and national economies. Effective policy builds on rather than ignores or counteracts such accumulated capability.
- **Innovating firms tend to cluster.** Multiple studies have suggested that successful firms gather together geographically, either ‘horizontally’—groups of firms in the same type of business—or ‘vertically’—firms connected in related value chains... Clustering appears to help overcome limitations of scale.
- **Innovating firms in all sectors employ knowledge not developed internally.** Many new products (and processes), while not spawned by scientific discovery, draw upon knowledge not possessed by firms....’.

Translated into the purchaser-provider context, these findings imply that, despite the incentive of a rolling performance base line, competition will not by itself be sufficient to drive innovation. Competition may drive efficiency but it is not sufficient to drive continuous improvement. For this to occur the knowledge system must also be appropriately configured. But processes of knowledge generation and dissemination are sector and indeed activity specific (e.g. March, 1999). For example in disability employment at least thirteen distinctive ‘knowledge blocks’ are relevant to agency performance.² More generally, innovation theory emphasises the segmented character of knowledge and the barriers to research and dissemination. The development of appropriate knowledge requires exchanges and linkages that extend beyond individual organisations. It may also require an investment of resources that is beyond the capacity of individual organisations. Or it may require different systemic arrangements or different patterns of collaboration and coordination between

¹ Basri, E. ‘Inter-firm Technological Collaboration in Australia: Implications for Innovation and Public Policy’, in OECD *Innovation Networks: Co-operation in National Innovation Systems*, OECD Paris, 2001.

² These are the key organisational and other processes that are involved in gaining employment:

1. *Marketing to clients and referral agencies*; 2. *Assessing client needs*; 3. *Approaching employers*; 4. *Matching clients and employers*; 5. *Training clients*; 6. *Ongoing support*; 7. *Information systems*; 8. *Performance review*; 9. *Recruiting employees*; 10. *Managing staff*; 11. *Managing finances*; 12. *Mergers or consortia*; 13. *Governance*.

organisations, which it is not in the interests of any individual agent acting alone to promote. In sum, ensuring that the knowledge system is appropriately configured is the essential condition for continuous improvement.

Speed of dissemination is a second factor. The distinguished Swedish economist Lundvall (2004) notes that the key test of a 'learning system' is the speed in moving from a gain in knowledge to its application; indeed because of its systemic implications, he holds this activity is no less important than the breakthrough itself. In a study of the disability employment sector in the United States, Rosenheck (2001) noted the role of intra-sectoral and inter-organisational collaboration in rapid dissemination of 'best practice':

'The first step (in dissemination) is the construction of leadership coalitions that favours implementation and that can provide on-going support....The eventual outcome of such efforts depends....on the strength of the coalition, the resources it commands and its persuasiveness...If the impetus for implementation comes from lower down in the organisation – closer to the grass roots – it is much more likely to succeed ...The development of a self-reinforcing, program-specific subculture is perhaps even more important than the monitoring and enforcement of program standards....The key to developing such a community of practice is frequent interaction. Such interaction allows members to make sense of their common experience and to codify their jointly accrued knowledge in catchphrases, symbols and stories' (p.1610-1611).

Innovation in Public Sector Settings:

In its assessment of challenges to the New Zealand public service, the UK think tank Demos (2006; also Mulgan and Ashbury, 2003) emphasised the desirability of basing innovation on the experience of front line workers and providers:

'Public services are human systems in which change is at least as likely to happen at the front line interface between state and individual as it is in central policy departments. This offers the opportunity to create a genuine learning system within government which can in turn drive a more evolutionary model of reform and management – trying lots of things serially, seeing which works best, doing more of them, repeating as necessary...By helping citizens become involved in the process of change this organic and evolutionary approach should create its own legitimacy with the counties that take part in it' (p. 19).

And later

'Innovation in public services is little understood, but the work carried out in this area is challenging to "command and control" models of governance...such approaches to reform are built on the belief that *people* (their italics) throughout organisational hierarchies will respond predictably to pressures and incentives set from above ..Such assumptions rarely reflect the reality in which individuals and professional groups learn to "game the system", often in response to concerns over the impact of particular rules and regulations on service users themselves... But rather than trying to neutralise this inherent human tendency, governments should be learning how to harness it to achieve the goals of policy' (p. 48)

Elsewhere, Grosfeld et al (2004, p. 39-40) identified five key problems in innovation system governance in the public sector. Their recommendations emphasise the desirability of deliberately fostering learning and knowledge exchange:

- Too strong a focus on accountability at the expense of more strategic goal setting
- A missing link between strategic intelligence and policy design
- A lack of vertical coherence between government strategy, policy design and implementation
- A lack of transparency, especially in the policy design phase
- A lack of coherence over time because of a focus on single solutions rather than continuous improvement.

Similarly, in a study of innovation in government Borins (2006) noted the importance of gathering information across a variety of organisations and focusing efforts on frontline service providers:

'Innovation crosses boundaries: Around two-thirds of the innovations in the US and advanced Commonwealth countries involved a 'whole systems' analysis of the problems and solutions that involved different organisations working together.

Innovation happens at the frontline: Frontline workers and middle managers account for half of the innovations generated in the US and developing Commonwealth countries, rising to 82 per cent in advanced Commonwealth countries. Policies that empowered communities, citizens or staff to drive change account for between 14 per cent and 30 per cent of the innovations surveyed.

Recent literatures on innovation, organisational behaviour and public management all underline the desirability of basing continuous improvement on knowledge exchange. Where continuous performance improvement is the objective, market failure is chronic. A quasi-market could be expected to contribute one-off efficiency gains, but it is unlikely to generate continuous performance improvement. Rather, those

literatures concur in suggesting that innovation or continuous improvement involves at least four tasks: engaging front line agencies and/or workers; facilitating collaboration and exchange between agencies; ensuring linkages between researchers and service providers are appropriate; and building local networks. Above all, they suggest that market relationships may be a necessary element of an innovation system. But they are not sufficient. Where continuous improvement is the goal, a knowledge system that is configured to be congruent with the needs and organisational features of the specific sector needs to be instituted. Does practice in the disability employment sector vindicate these claims?

II. Collaboration and Performance Improvement

To test the relevance of these propositions to disability employment a survey was undertaken. The Disability Employment Network (DEN) is a network of agencies specialising in assisting people with disability into employment. There is significant diversity among DEN providers, in terms of size, age and type of service. Most services are generalist, assisting people with a range of different disabilities. Other services specialise in assisting people with particular disabilities, the most common being intellectual disability, psychiatric disability and physical disability, although there are small numbers of providers in a range of other specialisations (Wade and Bell 2003, 7).

The sector has experienced considerable policy change in recent years. Since 2004 Open Employment Services for people with disability have been gradually shifted from block funding to case-based funding, a form of outcome-based funding. Then in 2006 changes to welfare to work provisions created a new stream of services. Some people with disability became subject to mutual obligation. Assistance for these clients was ‘uncapped’, meaning the number of places would meet the new demand, unlike the existing, and continuing, ‘capped’ stream, where places were limited. This latter stream caters for voluntary job seekers.

The survey was conducted in partnership with ACE National, the industry association representing disability employment agencies. Respondents were managers of

disability employment agencies that were members of ACE National. A random sample of 120 agencies was contacted in July 2006, representing two-thirds of ACE members, and over half of all agencies (ACE membership is approximately 80 per cent of the industry). Seventy-eight valid responses were collected, representing a response rate of 65 per cent, a high response rate by normal standards, and higher than comparable studies (for example Wade & Bell 2003).

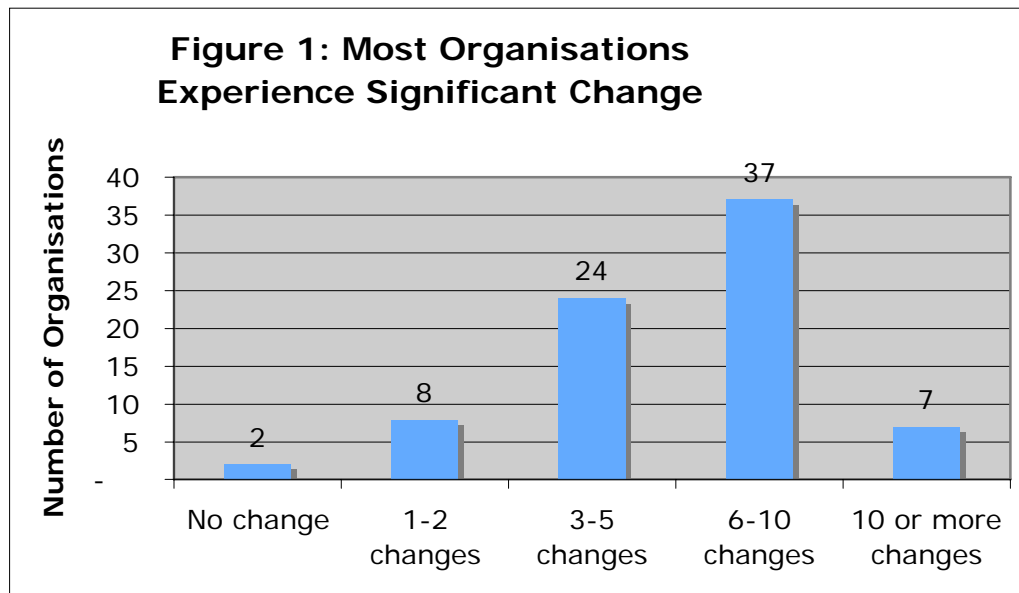
The survey included five sections, focusing respectively on: organisational features; staff and management; recent changes in processes and other innovations; networking and collaboration between organisations; and measures of success. The following paragraphs specifically focus on two sets of results, namely those covering recent changes in processes and networking and collaboration.

The section on changing processes and innovation was the largest section of the survey. This section asked questions about the principal functional areas in the organisation, including marketing to new clients, training processes, managing finances and the approach to working with employers. In total, the survey focused on 13 areas where processes might have changed, in addition to an open-ended question about other areas of change (see footnote 5). These functional areas (or knowledge blocks) were identified through review of previous literature and a series of interviews and focus groups with agency managers. The survey asked about processes, how processes had been changed, why change had taken place, where ideas for change originated from and whether change produced more effective outcomes.

The fourth section of the survey explored the role of inter-agency networking and collaboration as a strategy for improving performance. The survey asked respondents about the ways in which senior staff and other staff networked both within and across agencies. It also asked respondents to give examples of where collaboration had been helpful and to discuss how collaboration might be becoming either easier or harder under the new regulatory framework.

The survey results revealed an industry in the process of significant change. Only two of the 78 organisations responded that no changes had been made to the processes in any of the 14 (the original 13 with an additional 'other category) knowledge blocks.

Forty-four of the agencies, or 56 per cent of the sample, reported that changes had been made in at least six of the knowledge block areas (Figure 1).



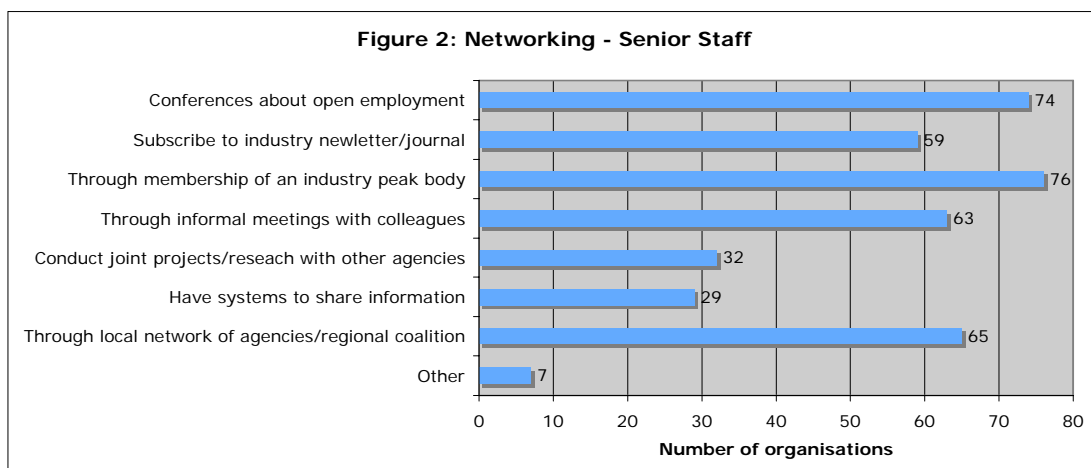
The nature of change varied widely over the knowledge blocks (for a full account of the changes see Marsh and Spies-Butcher, 2007). Much change resulted, directly or indirectly, from the new regulatory environment. There was substantial evidence that the industry had responded positively to this change. Most respondents perceived changes as leading to improved outcomes. Asked what effect the changes had had on performance, respondents were ten times more likely to answer ‘positive’ than ‘negative’. This proportion was lower for changes that respondents identified as government initiated, but even within this sample of changes respondents were five times more likely to answer ‘positive’ than ‘negative’.

These results indicate a sector that is responding positively to a rapidly changing environment. Organisations are implementing wideranging changes at a rapid pace. Moreover our respondents did identify positive effects from change, and were generally open to improving their processes, even when prompted by government action.

There is a clear link between the high degree of openness to change and the level of information exchange in the sector. The evidence from the survey indicated that

networking and collaboration are well established within the sector at all staff levels and that these links have been critical in disseminating good practice:

Senior Staff: In over three quarters of the providers surveyed, senior staff networked through membership of a regional coalition or network of agencies (83%), or through informal meetings with colleagues (81%). Industry journals also played an important dissemination role with 76% of respondents nominating this as an important source of ideas. In almost all (97%) of the providers' senior staff also networked through industry association membership. This is not surprising as the sample was selected from the membership of the industry association – although it does indicate an appreciation of its role. In virtually all of our sample organisations, senior staff attended conferences about open employment (95%).

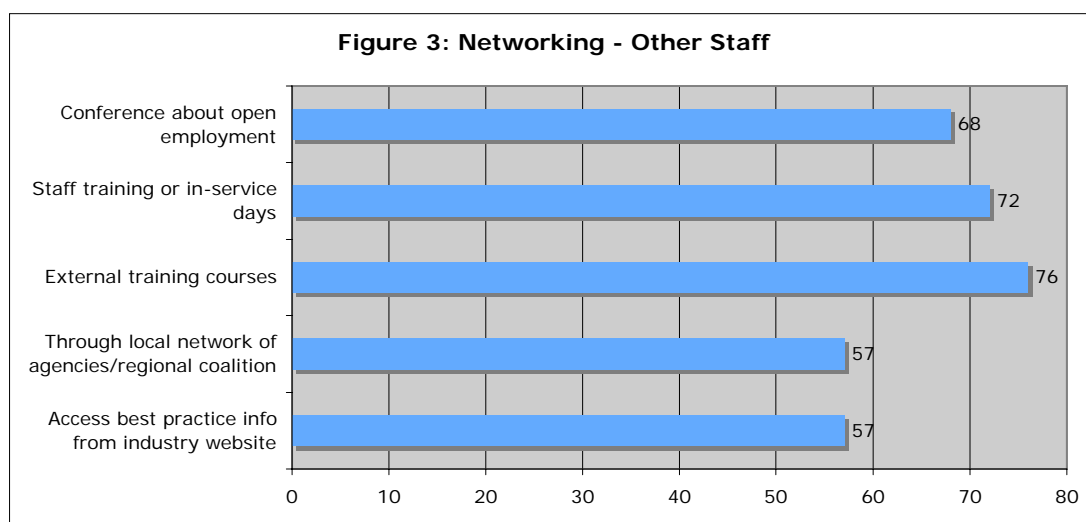


There were also significant numbers involved in some more intensive forms of networking and collaboration. *Over 40% of the sample conducted joint projects or research with other agencies.* And over a third had systems in place to exchange information about clients or employers. These numbers are surprisingly high given the extent of interaction required.

Staff Collaboration: The engagement of non-management staff in collaboration and networking was similar. Seventy-three per cent of non-management staff were involved in regional coalitions, while 87 per cent attended conferences about open employment. The ratio of management to non-management participation is similar in both instances, suggesting that while non-management staff was less likely to be

involved, there does not appear to be any specialisation of management staff in one area and non-management in another.

Non-management staff were also involved in a range of other activities that allowed them access to networking opportunities or to exchange ideas. Almost all had access to external training courses (97 per cent) and most to staff training days or in-services (92 per cent). A surprisingly high 73 per cent also accessed best practice information from the web – indicating that this is an effective mechanism for transmitting information throughout the sector.



Examples of Collaboration: Collaboration is central to the activities of most providers in the sector. Importantly, our survey asked respondents to name a specific example of collaboration they had engaged in over the past two years. This was an open question. Over 70 per cent of providers were able to name a specific example of collaboration, ranging from the formation of joint companies or establishing cross-over directorships, to more ad hoc and limited collaborations with other agencies.

Even where these interactions were more ad hoc, they were a powerful source of best practice information. One smaller agency gave an example of learning how to improve practice from a visit to a neighbouring agency,

“(We) had contact with another agency in Gosford, visited the agency and were shown how to apply for a job placement contract and the value of doing this. This is now in the process of being implemented.” Respondent 5.

In many cases collaboration was more formalised. A medium sized agency gave a number of examples of working with different organisations to improve practice,

“We worked with the uni on advertising... (we) go to monthly network meetings (with other DEN agencies). We work with the schools on a transition to work program.” Respondent 44.

Collaboration around shared costs, like training and research, were common themes in a number of responses. The following are two examples, both from smaller agencies, of working collaboratively on training and other shared tasks, helping to gain economies of scale,

“We have run training and invited other agencies to be involved in that training, e.g. legal issues around disclosure. Also, in consultations with government departments, we tend to get together beforehand and work out joint strategies.” Respondent 66.

“Yes, we collaborated with another organisation to purchase an induction training resource and we paid for a facilitator to implement and mentor based on the resource.” Respondent 25.

Regional coalitions or networks of agencies are also common. These bodies often have formal structures, in addition to regular meetings, bringing together DEN providers at the local area. One of the larger respondents gave an example of one regional coalition in Western Australia,

“Yes, throughout rural Western Australia managers of open employment services meet once every 10 weeks, which provides managers best practice ideas and support on how you're going. Secondly, once a year we make a visit to another agency and look at their practices and how they're implementing their program.” Respondent 36.

Agencies have also collaborated during the process of regulatory change, working together to come to grips with the new system. Not only is this an aid to organisations, it is likely an aid to government by reducing the need to work individually with agencies to clarify new regulatory requirements. Another smaller agency gave an example,

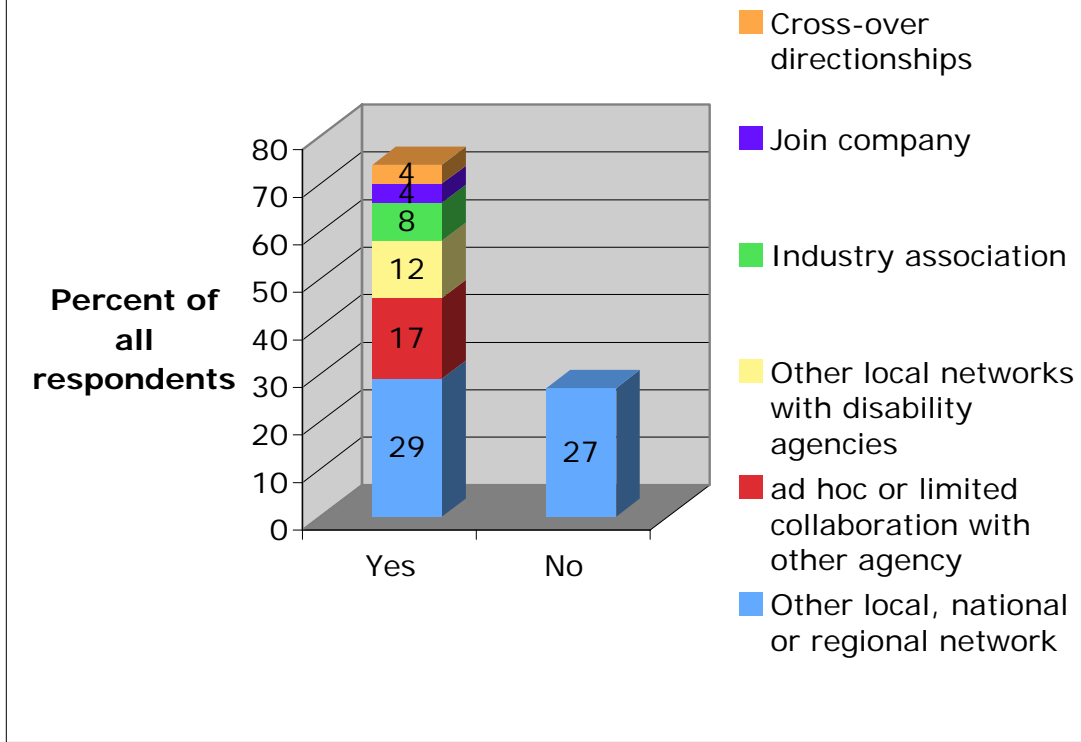
“We talked to other services around the time of the uncapped tender- sharing ideas about how to go about the process, how to interpret certain requirements etc. in the absence of information from the Government.” Respondent 29.

Other agencies looked to peak bodies to provide the infrastructure for collaboration and sharing resources and ideas. One medium sized agency from rural Queensland commented,

“We find collaboration very difficult because we are geographically remote from other agencies. We tend to share information more through our peak bodies.” Respondent 21.

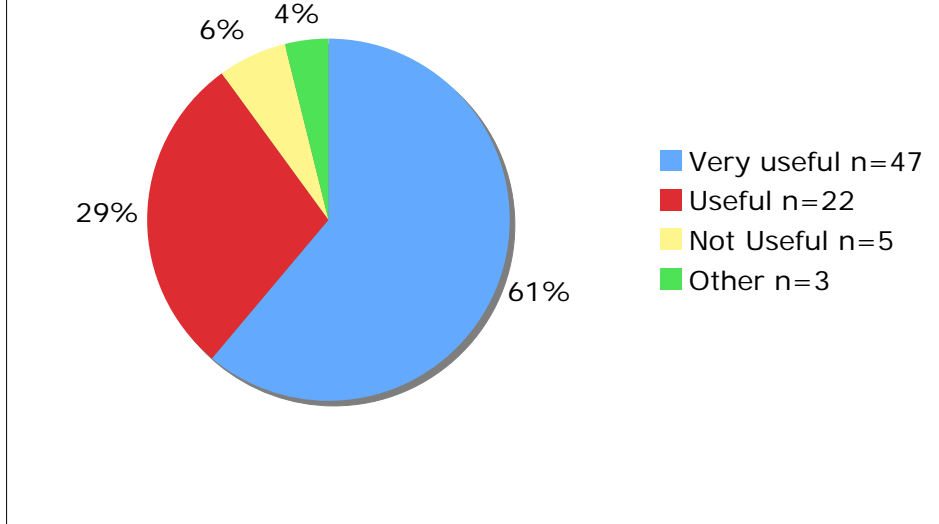
Most collaboration, involving 40 per cent of all respondents, came through engagements with other open employment providers, either locally, through a regional coalition or through an industry association. These forms of collaboration are most sensitive to changes in the competitive conditions within the sector. It is here that competition between providers has the greatest potential to threaten the cooperative ties and networks required to build collaborative partnerships.

Figure 4: Collaboration

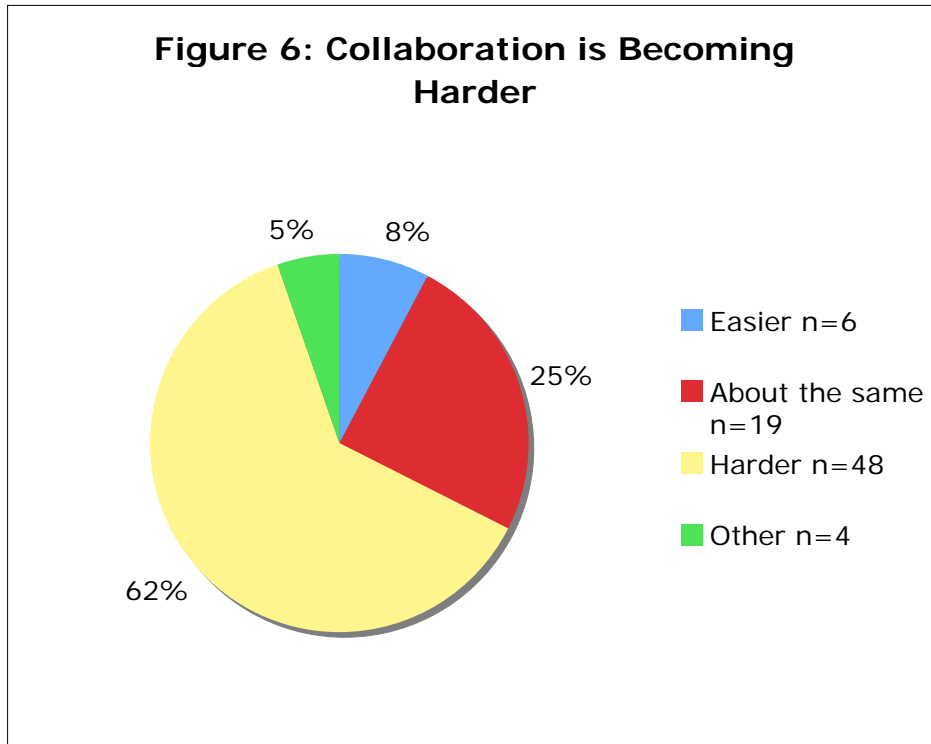


The Contribution of Collaboration: The importance of collaboration and an awareness of the sensitivity of collaboration to competitive pressures were born out in the data. *Ninety per cent of respondents said that collaboration was either useful or very useful in improving an agency's performance, 61 per cent responded that it was very useful.* Together these figures indicate that collaboration is a central part of providing open employment services for most of the sector, and is likely a key ingredient in the success of the sector in responding to the rapid change it has seen over the past few years.

Figure 5: Is Collaboration Useful in Improving Performance?



The Future of Collaboration: Given the centrality of collaboration and networking to the sector, it is troubling that over 60 per cent of our respondents believed that collaboration is getting harder. In contrast less than 10 per cent (six respondents in total) believed collaboration is getting easier. This certainly suggests that the regulatory reforms implemented by the Commonwealth, while stimulating significant change in the sector, have potentially less desirable long term consequences.



Respondents consistently identified the new system of competition, particularly the STAR rating component, as the main threat to collaboration. Competition was mentioned by every respondent who believed collaboration was becoming harder. One smaller provider explained their concern as,

“...the direction that DEWR is taking with open employment, down a competitiveness path, will start preventing services from talking to one another and sharing information and skills, and clients will lose out in the end as best practice is not shared...” Respondent 3.

Another larger organisation catering for over 200 clients with multiple outlets also identified competition as a barrier to collaboration,

“Competition. We only feel comfortable talking freely to services interstate because there are so few services down here and we're now in direct competition.” Respondent 64.

Relative Benchmarking: The STAR rating system is based on relative benchmarking. Each agency is ranked according to how well it performed against benchmarks that

purport to reflect the difficulty of its circumstances and client base. Those agencies that perform relatively better than others achieve a higher rating. The rating system is based on the system currently used in the Job Network.

However, many respondents felt that this relative benchmarking approach raised serious concerns. In their responses to the survey they said that the relativity of the rating system forced them into direct competition with other providers – it simply was not possible to assist others to do better without becoming relatively weaker. They feared that this was the reason collaboration was becoming harder. As one large provider put it,

...(Collaboration is becoming) much harder because government has introduced a relative competitive system where in order for me to survive I have to beat other services so collaboration is no longer in our best interests... Best practice will not be shared as freely in the future... Job Network has never shared best practice whereas DEN has been quite open in sharing best practice, which has been beneficial for jobseekers and overall effectiveness of services. So DEN will now adopt a Job Network paradigm. Disability servicing is far more complex than the generic job network and our success has been built upon liberally sharing research results in particular disability groups, which I believe cannot be obtained by individual agencies. For example, DEN agencies can band together to research a particular disability group and find out best practice and then share information with other agencies. It is not possible for one agency to effectively research and apply best practice individually to the range of disability types we need to service without significant levels of cooperation. So overall the changes are to the detriment of people with disabilities.” Respondent 72.

Summary:

This demonstrates a sector that is engaged in learning and information sharing. Networking is clearly central to the way in which most providers do business. This is not altogether surprising. Networking is widely viewed as crucial in many non-profit industries, and the learning that occurs at networking events, such as conferences and training days, has almost certainly become more crucial as regulatory changes have

required significant adaptation. These figures indicate that providers are willing to embrace change, but are concerned by the implications of some elements of the current competition framework.

III. Experience with the Job Network

Evidence concerning the impacts of competitively based purchaser-provider architectures is also available in the workings of the Job network. After its first contractual round, the Productivity Commission staged an enquiry in 2002. More recently a large provider, Catholic Social Services Australia (CSSA) has undertaken its own analysis of impacts. These findings are summarised in the following sections.

Productivity Commission Recommendations.

The 2002 Productivity Commission (PC) enquiry into the Job Network canvassed the merit of introducing a *research and dissemination capacity* aimed at building understanding of the requirements for performance improvement. The PC report noted: ‘An outcomes-based approach does not need to specify what processes are used by providers to get jobs for their clients as competition over time should shift providers to the best methods. However *it may still be in the interest of the purchaser to discover what processes are actually most effective and to diffuse these results among their suppliers* (our italics) (Chapter. 3.16 and Chapter 14.25-29). Later (Chapter .22) the Productivity Commission noted weaker cooperation between providers might be considered a primary disadvantages of a policy framework based on outcomes and price competition.

The Productivity Commission noted the role of Area Consultative Committees in fostering collaboration between providers and related agencies. It highlighted the role of National Employment Services Association (NESA: www.nesa.com.au). ‘NESA itself holds conferences, industry seminars, and special interest group meetings. The Partnership Program introduced as a joint initiative of DEWR, Centrelink and NESA also helps. And DEWR has implemented (this was in January 2002) a new National Contract Management Framework across all contracted employment services, which places a “greater emphasis on quality of services provided to job seekers and the

promotion of better practice to improve performance” ’ (Report, 14.26). The PC recommended funding a continuing research arrangement, similar to that in the Adult Migrant English Program, within Job Network.

The 2002 Productivity Commission enquiry into the Job Network also questioned four aspects of the contracting architecture. First, the Productivity Commission noted the impossibility of *accurately pricing outcomes*. Because the supply function is not well understood, the government cannot define the quantity of outcomes. ‘Neither bidders nor purchasers know much about the degree to which higher prices (or underlying investments in the employability of job seekers) will yield greater gross outcomes. They know even less about net outcomes’. The government responded to this recommendation in the third tender round. Sixty per cent of capacity was rolled over to existing suppliers and the government replaced price competition with centrally determined prices (Keating, 2004, p. 91-94).

Second, the Productivity Commission reviewed the scope of *outcome measures*. It noted the potential importance of a contribution to social capital: ‘Social integration and social capital (might be regarded) as a valuable output in its own right, but critically measuring this and incorporating it formally into a payments process may be difficult....It may be possible to incorporate further quality assurance or other assessments of quality into performance measures, but this involves a trade-off with the risk of micro-management’ (PC, 3.15).

Third, the report noted that the focus on employment outcomes may not fully recognise the needs of clients who require multiple interventions across the system. Incentive arrangements do not cover this activity. The prior classification of clients may not obviate this problem unless categories are sufficiently refined to accommodate people who have multiple disabilities. A concern to design a system capable of delivering appropriate multiple interventions is also evident in a recent UK report (The Freud Report, 2006). This evaluated placement services for all categories of longer term job seekers and recommended a ‘joined up’ approach which seeks to cover the spectrum of needs of longer term unemployed people, including people with disabilities. It emphasised the need to associate this with ‘full transparency of performance’ (Chapter 3, p. 63)

Finally, the Productivity Commission recommended a range of steps to inhibit creaming and parking by service providers. Several were subsequently adopted by the government. These included a Code of Conduct for providers and their inability to refuse clients (Keating, p. 92). The Freud report also commented on the success of this approach. Referring to outcomes for the longer term unemployed, it stated: 'The Australian experience is less clear-cut than many of its proponents suggest.....Costs have been considerably reduced. However, the system has proved less successful at preventing long term unemployment.....it may be that (the pricing and payment system) is not high enough to incentivise providers to deliver the service required to every participant, leaving some parked as too difficult to help' (Chapter 3, p. 57).

Catholic Social Services Report.

A subsequent review (Catholic Social Services Australia, 2006) found that the dysfunctional practices, anticipated by the Productivity Commission, have become even more entrenched. 'Significant systemic shortcomings are identified in the alignment of provider incentives (Financial and Star ratings) with all five dimensions of the government's expectations for the Job Network' (p. 5). The report enumerates dysfunctional behaviours and outcomes as a result of changed caseload characteristics, imprecise outcome definitions, and a mismatch between incentives and the requirements for speedy, sustainable and equitable outcomes. 'Potential rewards from financial incentives for outcome quality (speed, sustainability and equity of outcomes) perversely cancel each other out.' The CSSA report also identifies 'a similar effect with respect to Star Ratings that cannot be quantified as accurately by providers without additional data available only to DEWR' (p. 7).

Corrective steps progressively introduced by DEWR have increased the level of micro-management with a consequent surge in transaction costs, affecting both agencies and DEWR. According to CSSA report: 'Since early June 2006, Centacare Employment has received requests to justify 113 claims for payment at the rate of over five or six a week. A quarter of the claims were for under \$200 with half of these under \$100. The amounts of money involved vary from \$17.93 to \$4,400 – some resulted in partial recoveries as low as \$9.81.....What this situation reflects is a

strongly risk-averse and controlling culture within DEWR that is at odds with contemporary business and risk management principles' (p. 19-20; see also *The Bulletin*, February 20th 2007, p. 20: following an audit in 2005-06 the Salvation Army was obliged to repay \$9.4m and Wesley Mission \$2.7m).

The report estimates DEWR's transaction costs to be equivalent to 15% of total program costs. Compliance costs amongst agencies are estimated to be even higher: 'Anecdotally, Job Network members have indicated that up to 50% of the aggregated time of site staff goes in administration rather than direct client contact.' Another report involved a survey of the views of Job Network frontline staff (Jobs Australia & Brotherhood of St Laurence 2005). Staff believed that reducing the administrative burden was the single most important change to improve the Job Network System. Three specific changes were identified: reducing paperwork which was also replicated on the EA 3000 computer database system; reducing the red tape around the Job Seeker Account; improving the EA 3000 system and limiting changes initiated by DEWR to systems and processes (p. 7).

The CSSA assessment concluded: 'A number of perverse incentives....are thwarting the achievement of the Government's objectives for the Job Network. These perverse incentives reduce the quality of service to job seekers, increase welfare dependency, distort the government's perception of comparative provider effectiveness and lead to unwarranted government outlays' (2006, p. 3).

Other independent evaluations indicate the many issues of social inclusion and capacity compound the circumstances confronting people with disabilities, colouring profoundly their opportunities of gaining employment (e.g. Thomas, 2007; Senate Committee 2006; Morris, 2006; Anglicare, 2006; NSW Parliament, 2007; HREOC, 2006).

IV. From 'command and control' to 'learning' relationships between purchasers and providers.

The survey of the disability employment sector that is the basis for this present case study generated three findings that are particularly relevant to the promotion of continuous performance:

- First, the survey identified the variety of ‘knowledge blocks’ that are associated with continuous performance improvement;
- Second, the survey established that there is very considerable variation in practices between providers which, after discounting for differences arising from vocational and client factors, still suggest very considerable scope to identify, develop and disseminate new knowledge; and
- Third, the past role of collaboration in achieving the latter outcome was identified, and provider concerns for the future prospects for this activity were clear. The potential contribution of collaboration to continuous performance improvement was also acknowledged in the Productivity Commission’s evaluation of the Job Network.

Further, preceding sections have explored the relevance of innovation theory to continuous improvement and evidence concerning the way purchaser provider structures have worked in practice in the Job Network. Present arrangements are broadly based on a principal-agent paradigm. But is the present approach fit for the purpose?

Principal-agent theory alerts principals to their problematic relationship with agents. They are encouraged to take deliberate action to counter asymmetries in knowledge, moral hazard, opportunism and shirking on the part of agents. Principals are invited to invest in determining the outcomes they expect from agents and to design contracts and incentive programs to reward appropriate, and to punish dysfunctional, performance (Miller, 2005). At least three basic features differentiate significantly the human services context:

- *First, the knowledge guiding the decisions of both principals and agents is provisional.* Both are operating with corrigible information and judgements.

Unintended consequences, ambiguity and difference abound. It is impossible to devise programs from first principles that survive the effort to realise them. In the case of the principal, this involves judgements about attainable outcomes and, in the case of agents this involves judgements about the practices most likely to enhance performance in the pursuit of these outcomes.

- *Second, the trade-offs involved in judgements about overall outcomes are complex and not consistent.* The principal is setting outcomes that need to reconcile efficiency and quality in a way that minimises incentives for provider gamesmanship, creates incentives for efficiency and that does so in a way that also promotes quality services for clients. Any one of the outcomes is complex. Their achievement in combination is a daunting challenge. Only the providers have information that is relevant to this latter judgement. The principal needs routine access to provider information in order to refine and develop her understanding of desired outcomes in the light of provider and client experience.
- *Third, providers' own knowledge of how to attain quality services for clients is varied and developing.* Providers own knowledge of how best to serve clients – and how best to establish organisational and governance routines that reinforce these outcomes, is itself corrigible and experimental. Different organisations will attain different outcomes and it will not be immediately apparent which represents the best achievement of not necessarily consistent purposes. Dynamic efficiency through the whole system thus requires the routine collection, assessment and dissemination of performance information amongst providers.

An alternative framework for purchaser-provider relationships in human services has been championed by Professor Charles Sabel (e.g. 2007, 2006) This 'experimentalist' or pragmatist approach represents a logical development of current architectures – but one that promises to shift exchanges from a primarily punitive to a primarily learning basis. This builds on earlier work on continuous performance improvement and 'learning by doing' – an approach to dynamic efficiency that was developed by the Toyota Motor Company in its management of buyer-supplier relationships (Sabel, 1992). In the management of purchaser-provider relationships, Sabel proposes an

experimentalist or pragmatist paradigm to guide the policy design (Dorf and Sabel, 1998; Sabel, 2006).

Sabel's approach is based on the inappropriateness of hierarchical approaches in contexts in which continuous performance improvement is the goal:

'After 1980, for reasons we do not know, and may not ever fully understand, the world becomes too volatile for hierarchies....(which fail) to capture the idea that information in an organisation flows up and down as well as sideways.....General goals or designs are set provisionally by the highest level – parliament, a regulatory authority, or the relevant corporate executives – through benchmarking.....then the provisional goals are revised in the light of proposals by lower level units responsible for executing key aspects of the overall task' (p. 11).

The tools used to determine best practice have been pioneered and proven in a wide variety of commercial and public sector settings. These include.... 'routines such as benchmarking, simultaneous engineering, continuous monitoring, error detection and root cause analysis...(which) define methods for choosing provisional, initial goals and for revising them in the light of more detailed, partial proposals arising from efforts to implement them' (p. 11)

Sabel's approach proposes to reverse the direction and substance of the exchange between purchasers and providers: 'Compliance or accountability in the principal agent sense of rule following is impossible. There are in effect no fixed rules, or, what comes to the same thing, a key rule is to continuously evaluate possible changes in the rules. *Accountability thus requires not comparison of performance to a goal or rule, but reason giving: actors in the new institutions are called upon to explain their use of the autonomy they are accorded in pursuing the corrigible goals* (our italics).

These accounts enable evaluation of their choices in the light of explanations provided by actors in similar circumstances making different ones and vice versa. To encourage this kind of ongoing mutual reflection monitoring is continuous, or nearly so, rather than occasional or episodic: and it is less concerned with outcome measures than with diagnostic information – information that can redirect the course of "treatment".

When failure to follow the rule in principal-agent systems is, in theory, immediately penalised, in pragmatist systems non-compliance in the sense of inability or

unwillingness to improve or otherwise respond to change at an acceptable rate triggers...increased capacity enhancing assistance from the oversight authority. Repeated failure to respond, even with assistance, is, however, likely to bring about the dissolution of the offending unit' (Sabel, 2006, p. 14)

This broad approach has been widely tested in a variety of human services and other public policy settings in the United States including teaching disadvantaged students (Liebman and Sabel, 2003), defence contracting (Dorf and Sabel, p. 332 et seq), environmental regulation (ibid. p. 373), nuclear regulatory safety (ibid. p. 370), policing in deprived neighbourhoods (ibid. p. 327), occupational health and safety (ibid. p. 358) etc.

Pragmatist or experimental principles define an approach to the management of purchaser-provider relations wholly different from the structure that now governs the DEN network. Of course, in shifting towards a pragmatist architecture, much remains to be done to work out specific details in relation both to the specification of outcomes and the design of an appropriate governance structure. But the broad thrust of an alternative approach is clear.

This paper has explored the fit between the present purchaser-provider architecture and continuous performance improvement or innovation in client services. Empirical evidence has been derived from the disability employment network. This group of agencies caters to the needs of a singularly disadvantaged segment of the Australian population. For these individuals, it seeks an outcome that elsewhere contemporary society takes to be fundamental to citizenship – the opportunity to work. The quasi-market framework that is being introduced to this sector represents an attempt to enhance this outcome in a way that recognises the twin imperatives of expenditure restraint and complex client needs. The trade-off between these imperatives cannot be specified definitively *a priori*. This determination is necessarily provisional at the outset and corrigible as experience and learning accumulate.

This study has marshalled theoretical and empirical evidence from a variety of literatures and perspectives. Together these suggest that the present framework is not, by itself, likely to achieve continuous performance improvement, or at least that it

will significantly under perform compared to what is attainable. At a theoretical level, while quasi-market arrangements encourage static efficiency gains, their ability to foster dynamic efficiency (or innovation or continuous improvement) is much more problematic. Empirical work has confirmed these theoretically based expectations. Indeed, contrary to its espoused intent, the quasi-market framework is, through its incentive structure, more likely to encourage dysfunctional behaviour on the part of agencies. It will discourage the exchange of best practice information. Through problems of client classification and outcome specification, it may work to diminish services for those most in need of assistance. And it introduces positive incentives for selection of the easiest categories of clients. Finally, countering these perverse outcomes has multiplied transaction costs.

To overcome these difficulties two strategies would seem to be available. One could involve the development of centrally based research and dissemination arrangements to supplement the competitive framework. The introduction of technical assistance capabilities could supplement the STAR Ratings Framework. If an acceptable arrangement could be successfully designed, this might build confidence amongst agencies in the fairness of the system and enhance continuous improvement in the sector. Similar targeted arrangements may be appropriate in other human services contexts. In each setting, the key need is to establish how problems are identified, how knowledge is generated and how it is disseminated and implemented in day-to-day practice. Only on this basis can continuous improvement in client services be anticipated.

The paper also briefly canvassed a complementary 'experimentalist' or pragmatist approach to system design. This would build on the broad structure of purchaser-provider relationship, but place exchanges in a context that emphasises learning by both parties. This approach merits consideration not only because it would encourage continuous performance improvement but also because it promises to transcend fundamental difficulties in present arrangements. These include the corrigibility of outcomes, the high and increasing level of transaction costs, the increasing turn to micro-management and the consequent confounding of the freedom of action of suppliers. Indeed this experimentalist approach has wide potential application throughout public sector purchaser-provider systems.

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