



VALUE-BASED MANAGEMENT IN GOVERNMENT

DOUGLAS W. WEBSTER | GARY COKINS

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**DOUGLAS W. WEBSTER
AND GARY COKINS**

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About the Authors

DR. DOUG WEBSTER HAS EXTENSIVE EXPERIENCE BOTH leading and consulting to public sector organizations. He is a past CFO of both the US Department of Labor and the US Department of Education, where he led financial management for organizations with budgets exceeding \$60billion. As the Director of Government-to-Government Risk Management for the US Agency for International Development (USAID), he led development and oversight of all risk management worldwide for USAID funding through foreign governments. As a management consultant to over two dozen public sector organizations, he has advised and led projects implementing cost management, performance management, risk management, strategic planning, and organizational realignment. He has also provided management consulting services in a dozen countries and worked in nonconsulting roles in over three dozen countries.

Dr. Webster is also an internationally recognized expert in Enterprise Risk Management (ERM). He convened the very first group of senior federal executives interested in ERM and guided that group in convening the annual Federal ERM Summits beginning in 2008. He then led the transition of that group into the Association for Federal Enterprise Risk Management in 2011. He has guided the development and implementation of ERM at both the USAID and the US Department of Education as a government leader, and has provided ERM consulting services to several federal agencies. He developed and taught a course on ERM for George Washington University, and has served as an adjunct professor in strategic planning, financial management, managerial accounting, engineering economic analysis, and business ethics. He is the coauthor of four books: *Activity Based Costing and Performance* (1994), *Chasing Change: Building Organizational Capacity in a Turbulent Environment* (2009), *Managing Risk and Performance: A Guide for Government Decision Makers* (2014), and *Value-Based Management in Government* (2019).

Dr. Webster is an elected Fellow of the National Academy of Public Administration (NAPA), Director Emeritus at Pentagon Federal Credit Union, and a member of the National Science Foundation Business Operations Advisory Committee. His certifications include Project Management Professional (PMP), Certified Government Financial Manager (CGFM), Certified in the Governance of Enterprise IT (CGEIT), Prosci Organizational Change Management, and the RIMS Certified Risk Management Professional (CRMP) (including federal certification). His degrees include a BS in engineering, MS in systems management, and Doctorate in Business Administration.

Gary Cokins is an internationally recognized expert, speaker, and author in enterprise and corporate performance management improvement methods and business analytics. He is the founder of Analytics-Based Performance Management, an advisory firm located in Cary, North Carolina; www.garycokins.com. Gary received a BS degree with honors in industrial engineering/operations research from Cornell University in 1971, and his MBA with honors from Northwestern University's Kellogg School of Management in 1974.

Gary began his career as a strategic planner with FMC's Link-Belt Division and then served as financial controller and operations manager. In 1981 he began his management consulting career first with Deloitte consulting, and then in 1988 with KPMG consulting. In 1988 with KPMG, Gary was trained by Professor Robert S. Kaplan of the Harvard Business School on implementing activity-based cost management (ABC/M) systems. He subsequently wrote several books on ABC/M. In 1992 Gary headed the National Cost Management Consulting Services for Electronic Data Systems (EDS), now part of HP. From 1997 until 2013 Gary was a principal consultant with SAS, a leading provider of business analytics software.

Gary is certified in Production and Inventory Management (CPIM) by the American Production and Inventory Control Society (APICS). He is active on committees with the Institute of Management Accountants (IMA) and served a three-year term in 2016–2018 as the IMA's Executive in Residence. He has served on the ABC advisory board for the International Monetary Fund.

His two most recent books are *Performance Management: Integrating Strategy Execution, Methodologies, Risk, and Analytics*, and *Predictive Business Analytics*. His books are published by John Wiley & Sons.

One interesting honor that few know about Gary is that he is in the Baseball Hall of Fame in Cooperstown, New York, for the "Oldest Computer Baseball Game," the result of his 1970 junior-year operations research game theory course project at Cornell.

Acknowledgments

I WOULD LIKE TO THANK THOSE COUNTLESS INDIVIDUALS I have had the opportunity to work with and learn from over many years. Whether in my early military career, my subsequent consulting career, or my federal service career, every job and every encounter has influenced who I am today. To allow that learning and collaboration to take place, however, I must acknowledge my wife of 44 years, Connie. She has been by my side every step of the way, put up with late nights and extended time away from home, and all the other elements of life that test one's patience. The emotional support and love she has provided have been every bit as important as the schools I have attended or the jobs I have held. Finally, I would like to thank my co-author, Gary Cokins. I have developed an approach to my interpretation of value-based management that I wanted to share with others. However, had I been waiting on myself to write such a book, it would likely have been years more to reach fruition. Gary saw the value in this message and agreed to team with me to turn a vision into reality. I clearly recognize that without Gary, this book would not have been written for a long time to come – if ever.

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I am forever grateful to my wife, Pam Tower, for tolerating my challenge to balance my work and family life. I would also like to dedicate this book to the late Robert A. Bonsack as a mentor and friend under whom I worked at both Deloitte consulting and Electronic Data Systems (now part of Hewlett Packard). It was a privilege for me to attend two prestigious universities, Cornell University and Northwestern University's Kellogg MBA program, plus gain meaningful experiences with consulting at Deloitte, KPMG, EDS, and SAS. But with privilege comes responsibility, and it is important for me to share what I have learned, some of which is in this book. Finally, I want to thank Doug Webster for co-authoring this book. There are three escalating "ships" – relationship, partnership, and friendship. Doug and I evolved to the third ship – "friendship."

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Foreword

THE UNITED STATES IS CURRENTLY THE WORLD'S major Superpower from an economic, military, diplomatic, and cultural perspective. However, the United States needs to learn from history and address the major challenges of today and tomorrow if we want to stay great and stand the test of time. For example, the Roman Empire fell for many reasons, including decline in political civility and moral values, fiscal irresponsibility, an overextended military, and an inability to control its borders. Does this sound familiar?

While the United States is currently the longest-standing republic, its current political system is neither representative of nor responsive to the general public. Too many federal elected officials are “career politicians” who are ideologically to the right or left of the “sensible center.” In addition, they do not embrace the “problem-solver” mentality that comprises the majority of the American voting population. Current disgust with partisan politics and a lack of progress on a range of large, known, and growing public policy challenges (e.g., growing deficit and debt burdens, impending social insurance program insolvency, immigration reform, deteriorating infrastructure, health-care reform, climate change, and changing national security threats) has caused many Americans to be turned off and tuned out on the daily partisan political battles and current gridlock in DC.

The fact that Congress has passed timely budget and appropriations bills only four times in the past 45 years serves as clear and compelling evidence that Washington is broken and has been for a long time. Furthermore, the fact that over 40 percent of American voters, and growing, do not want to be identified with a particular political party serves to reinforce this disgust with the status quo. Clearly major budget, policy, and political reforms are needed to revitalize our republic, regain the trust of the American people, and restore our stewardship responsibility to current and future generations of Americans.

The authors of this book are well aware that major tax, spending, political, and other reforms will be necessary to create a better future for all Americans. They also understand that irrespective of the future role of governments at all levels they need to operate in a more future-focused, results-oriented, economical, efficient, effective, and sustainable manner. In order to do so, the federal government needs to place much greater focus on “value-based management.”

This book provides an extensive overview of value-based management and how it can be applied to improve performance and ensure accountability in government. It properly recognizes that effective leadership and management requires taking some risks to achieve needed innovation and change. However, those risks need to be well understood and properly managed to achieve and sustain the desired outcomes.

This book can be a valuable tool for government leaders and managers who want to “lead by example” in improving the performance and ensuring the accountability of government for the benefit of the American people. The time to do so is now!

Hon. David M. Walker
Former U.S. Comptroller General

Preface

THERE IS A GROWING IMPATIENCE BY TAXPAYERS, citizens, and governance boards with waste and inefficiency that is leading to demands for evidence of outputs, outcomes, transparency, and accountability. Terms like “doing more with less” and “value for money” are prevalent and aimed at governments at all levels – federal, counties, cities, municipalities, villages, and towns.

A key word in the second term is “value.” This book is about how governments can increase the value to their taxpayers, citizens, and all stakeholders. The authors refer to this as “value-based management” (VBM).

Most governments have all the money to do *something*. However, they do *not* have all the money to do *everything*. This means they need to better prioritize and embrace productivity, effectiveness, and efficiency. They need to react. However, the longer they wait, the bigger will be the pain.

HISTORY AND THE AUTHORS' BROADER VIEW OF VBM

The idea that organizations seek to create stakeholder value, and consideration of how that value is increased and ideally maximized, is a relatively recent evolution in management theory and practice. The industrial revolution dates back to the end of the eighteenth century and the age of “Scientific Management” began with the industrial engineering luminaries Frederick Winslow Taylor and Harrington Emerson in the early twentieth century. Yet various approaches for calculating financial value, such as return on investment (ROI), discounted cash flow (DCF), capital asset pricing model (CAPM), and others, did not develop until the twentieth century to advance the discussion of the elements of value. Not until 1986, however, when Alfred Rappaport authored the book, *Creating*

Shareholder Value,¹ did the concept of value begin to enter the management lexicon. The first use of the term “value-based management” comes from Jim McTaggart in his 1994 book, *The Value Imperative: Managing for Superior Shareholder Returns*.²

While the term “value-based management” has been with us since 1994, universal agreement has never been reached on its meaning. Moreover, the term has largely been used in relation to shareholder and owner value in commercial sector companies. With the dawning of concepts like risk-adjusted return on capital (RAROC) in the 1970s, activity-based costing (ABC) in the 1980s, and enterprise performance management (EPM) methods such as the balanced scorecard in 1992, the stage was set for a broader, more meaningful discussion of what it means to manage value. Unfortunately, VBM has become mired in its history and remains largely focused on financial shareholder value for commercial private sector companies.

This book seeks to present a much broader view of VBM. Understanding the concept of value to support decision making related to every human endeavor expands VBM to a fundamental management concept, not some narrow concept focused on financial management of private sector companies. This broader concept, which seeks to integrate considerations of results to be achieved, resources to be effectively and efficiently consumed, and risks to be appropriately accepted, is a universal management model that applies in every situation. VBM applies from selecting any individual decision at the operating level up to managing the very largest organizations. It is from this vastly broader concept of VBM that we share how any organization – public sector, private sector, or not-for-profit – can better achieve its full potential to create and increase value.

SOME THOUGHTS ABOUT “VALUE”

Value is “in the eye of the beholder.” One individual or family will evaluate the value of a particular automobile differently than another individual or family. Parents may have different sets of criteria in determining value, as will the

¹Rappaport, Alfred (1986), *Creating Shareholder Value: The New Standard for Business Performance* (New York: Free Press).

²McTaggart, James, M. (1994), *The Value Imperative: Managing for Superior Shareholder Returns* (New York: Free Press).

various children of the family. Similarly, organizations evaluate the value of the choices before them. However, while individuals make these decisions to support their self-interests, organizations must make decisions to maximize the value delivered to a much broader and potentially more diverse set of stakeholders.

Stakeholder interests in private sector companies must be considered and balanced as a whole, as many such interests – sometimes in conflict with one another – can be key to the organization’s success. For example, shareholders seek a good return on their financial investment; customers seek value for money in the products or services they purchase; regulators seek compliance with laws and regulations; and employees seek competitive compensation, working conditions, and potential for advancement.

However, as diverse as these various stakeholder interests may be, public sector stakeholders in government can be considerably greater in number and even more diverse. Public sector agencies seek to meet citizen and taxpayer expectations, meet the needs of beneficiaries of particular services, comply with guidance from legislative bodies, and respond to many other stakeholder demands. Moreover, stakeholders of a public sector entity can have very divergent interests and expectations, thereby resulting in very different perceptions of what constitutes “value.” Just a single government agency at any level (e.g., federal, regional, municipal), for example, may have to deal with multiple funding or oversight committees with very divergent interests and definitions of “value.” This makes the articulation of overall value for a government agency’s combined portfolio of products and services typically much more challenging in the public sector than in the private sector.

OVERVIEW OF THE BOOK

The book’s chapters are organized into eight parts:

Part One introduces the subject of VBM. It begins with an essay chapter regarding dissatisfaction by citizens, taxpayers, and stakeholders with their governments. The second chapter describes VBM, including the need to balance what is referred to as the three Rs: risk, results, and resources. The concluding chapter describes the component methods that, like gears in a machine, should ideally be seamlessly integrated.

Part Two describes the process of identifying key stakeholders, evaluating what those stakeholders consider to be of “value,” and establishing strategic goals and objectives to be pursued in delivering that stakeholder value.

Part Three describes the shortcomings of enterprise performance management (EPM) as practiced to date, and how this book proposes an improved role for EPM.

Part Four contains three chapters that describe in depth the three Rs with a chapter devoted to each R.

Part Five contains six chapters that describe progressive management accounting practices and systems. It includes effective planning and budgeting, plus techniques to quickly implement these systems.

Part Six describes the role that information technology (e.g., software and databases) has as an enabler to inform and operationalize VBM.

Part Seven describes behavioral change management. Its premise is that resistance to change is human nature. People are comfortable with the status quo. There is need to overcome resistance and gain buy-in from those impacted by the changes required to achieve the full vision of VBM.

Part Eight describes the future of VBM that the authors envision with adoption of the VBM methodology and mindset.

BALANCED VBM BUT AN UNBALANCED BOOK

Part Five, involving resource and cost management, is unbalanced in terms of the number of pages in the book compared to the other two Rs in Chapter 6 on risk management and Chapter 7 on results management. This is because author Gary Cokins has substantial experience with management accounting methods and practices, including writing several books and many articles on this subject.

Part Five discusses the full spectrum of management accounting not only for measuring past period consumption of resources and their resulting costs but also the forward-looking future view of budgeting and “what-if” trade-off analysis.

The extensive length of Part Five is intended to educate practitioners (including consultants) on the “how,” not just the “why,” to design and implement progressive management accounting in organizations. If you are not directly involved with the CFO’s department, then the authors suggest that perhaps you read only Chapter 9 of Part Five and share the entire Part Five with accountants whom you care to influence to implement what is covered in this Part.

 **CONCLUDING REMARKS**

The authors believe that taxpayers, citizens, and stakeholders will be substantially better and more economically served if governments embrace VBM and implement the methods and technologies that support VBM.

PART ONE

**Value-Based Management in
Government Concepts and
Components**

Challenges and Solutions to Address Dissatisfaction of Citizens and Taxpayers

GOVERNMENT DEPARTMENTS AND AGENCIES at all levels are challenged to improve program and service performance. Public sector agencies are becoming performance-centric and citizen-centric, and their long-term survival depends heavily on agency innovation and the ability to demonstrate value creation.

In the US, the President's Management Council, composed of Agency Deputy Secretaries and led by the Federal Chief Performance Officer of the Office of Management and Budget, is demanding accountability with transparency and demonstrated effectiveness. Agencies not demonstrating results must defend their program missions and budgets. Compliance now means a more stringent assessment of programs and services with fact-based communication of performance. Furthermore, funding support relies on the continual improvement of programs. The bottom line is that funding is tied to clearly demonstrating and articulating results. Agencies that cannot do so face the risk of having their programs reformed, constrained, or even terminated. Agencies also stand to lose their budgets and face negative publicity.

The US federal government is not alone on driving performance. State, county, municipal, and local governments as well as governments of countries

throughout the world are responding to an increasing awareness of the need for fiscal spending responsibility and austerity. “More with less” is a common theme.

At the state and local levels, governors, legislatures, and citizens demand that agencies and departments provide transparency of their spending and demonstrate the benefit achieved in relation to government expenses. The same goes for international government agencies. Increasing budget crises with some agencies globally have prompted further scrutiny from lawmakers and the public for agencies to prove the effectiveness of their programs and services. Challenges for leaders now revolve around assessing costs, justifying budget requests, transparently assessing risk, and communicating expected and tangible results in the large context of driving value.

THE US'S ACCOUNTABLE GOVERNMENT INITIATIVE

There have been numerous government management improvement initiatives in the United States over the past century, such as the President's Committee on Administrative Management in 1937, the Commission on Organization of the Executive Branch of the Government in 1947 (also known as the Hoover Commission), the Private Sector Survey on Cost Control in 1982 (also known as the Grace Commission), and in 1993 the National Partnership for the Reinvention of Government. In 2001, President George W. Bush originated the President's Management Agenda to make government more “citizen-centered, market based, and results oriented” by focusing on human capital, financial accountability, e-government,¹ competitive sourcing, and budget and performance integration. In 2010 President Obama announced the Accountable Government Initiative to cut waste and make government more open and responsive to the American public. The announcement stated, “When government does not work like it should, it has a real effect on people's lives – on small business owners who need loans, on young people who want to go to college, on the men and women in our Armed Forces who need the best resources when in uniform and deserve the benefits they have earned after they have left.” Finally, in 2017, President Trump replaced the Accountable Government Initiative with a revised President's Management Agenda, which “lays out a long-term vision for modernizing the Federal Government in key areas that will improve the ability of

¹E-government, or electronic government, is the use of computers, the internet, and other electronic means to provide public services (see <https://en.wikipedia.org/wiki/E-government>).

agencies to deliver mission outcomes, provide excellent service, and effectively steward taxpayer dollars on behalf of the American people.”

According to the current President’s Management Agenda, the “Federal Government has become overly bureaucratic and complex in ways that have prevented agencies from seamlessly transitioning services to meet the needs of the 21st century. Many of these challenges and shortcomings arise from statutory, administrative, management and regulatory practices designed in the past that no longer align to the realities of today.”² The report goes on to list specific root cause challenges, including:

- Accumulated regulatory burdens
- Structural issues
- Decision-making and processes
- Leadership and culture
- Capabilities and competencies

The long history of management improvement initiatives in the US federal government demonstrates an ongoing recognition of the need for improvement in management practices. The history of such initiatives is a result in part of the changing needs for government management practices in the modern era. However, it also reflects increased insights into how those needs can be better met.

FROM PERFORMANCE-BASED MANAGEMENT TO VALUE-BASED MANAGEMENT

A US government website article³ states, “The federal government spent over \$4 trillion in fiscal year 2018, but according to a Gallup poll, more than 60 percent of Americans are dissatisfied with federal government services. When pressed to explain which services cost too much or why they think Americans don’t get what they pay for, there’s no clear answer. Instead, a general perception exists, often created by partisan politics and the media.”

A way to address this is to develop a uniform and consistent way to assess the cost-benefit trade-offs for each federal program. This is what the authors propose in this book.

² <https://www.whitehouse.gov/wp-content/uploads/2018/03/Presidents-Management-Agenda.pdf>, page 4.

³ <https://www.govexec.com/excellence/management-matters/2019/01/agencies-spent-4-trillion-last-year-did-taxpayers-get-what-they-paid/154087/>.

The article continues, “There are currently 2,277 domestic assistance programs offered by the federal government, according to the General Services Administration. Federal agencies administer these programs, reporting their cost and performance to the public according to federal management legislation such as the 1990 CFO Act and the 1993 Government Performance and Results Act. While these decades-old laws have gotten us far, they didn’t carry us over the finish line of fully-functioning performance-based management. We now have the opportunity to go the rest of the way. ... There is no comprehensive analysis of the 2,277 programs that administration and congressional staff can use to assist with their investment portfolio decisions.”

This book proposes to go beyond the article’s reference to “performance-based management” to “value-based management” (VBM).

What is needed to determine financial budget amounts for resources among government agency programs is framework like VBM for any government. To address this, like any effort to produce useful reports, one should first identify the users of cost and benefit data and understand how they will use the data. The article cites “There are four key decision-making groups to target with reporting improvements: program managers, senior administration leaders, the legislative body, and the public citizens and taxpayers.”

As an example, with its 2006 Federal Funding Accountability and Transparency Act, the US Congress required the Office of Management and Budget (OMB) to create www.USASpending.gov. This website segments financial spending data into 19 budget “function” categories to facilitate a standard way for comparative analysis of similar functions. The result is that it displays a complete spending picture for the federal government.

At the end of each fiscal year, the agencies are instructed to revise their reporting on this website, then various stakeholders can evaluate any agency’s overall performance as it relates to the cost of their services.

The article continues: “Merging cost and performance data in a way that significantly alters how Congress and the administration allocates resources and how Americans objectively gauge the performance of their elected officials has been the Holy Grail of performance-based budgeting for decades. It took a huge commitment of resources just to get to this point.”



WHAT DO GOVERNMENTS HOPE TO GAIN FROM VBM?

Six primary benefits for public sector organizations can be realized from implementing modern management methods:

1. Optimizing the use of resources
2. Aligning cross-departmental work activities and priorities with collaboration and increased accountability
3. Linking the budget and planning processes with an executive team's strategy
4. Displaying greater financial visibility and transparency for what outputs cost, and their drivers
5. Incorporating risk as an equal tradeoff consideration with results sought and resources committed
6. Maximizing overall stakeholder value delivered by the organization

The lack of alignment – typically a symptom of silo and bunker mentality – allows various departments to independently pursue their own pet projects rather than the more mission-critical ones to achieve their organization's overarching mission. Among taxpayers and governance boards, there is a growing impatience with waste in government. As previously mentioned, the phrase “more for less” increasingly appears in media editorials about government spending. A variation can be “more with same,” meaning maintain the same level of resource spending but produce better and higher results.

Chapter 2 will define and describe VBM. Subsequent chapters will then take a deeper dive into the various components that comprise the VBM framework.

Generating Value in a World of Uncertainty

FROM THE MOMENT WE enter this world as a baby until the moment we depart, we are constantly faced with choices. Those choices may range from the inconsequential to those having tremendous, life-long impacts. Those impacts can extend from us individually, to those immediately around us, and in some cases to many others around the world. Choices also differ from those that are very simple to make to those that are exceedingly complex and multifaceted. Choices can be focused on high-level, long-term objectives such as the selection of a professional career or interest, a more near-term selection of a university degree or educational program that will enable the choice of professional career, or even more near-term choices such as which classes to take, which professor to sign up with, or how much to study for an upcoming exam.

In all cases, however, individuals seek one general outcome for all choices: to maximize the value of that choice, whether in the short term or the long term. For example, if asked whether a two-seater sports car or an SUV offered greater value, a family needing to transport children to after-school activities might logically view the SUV as offering greater value while the bachelor or bachelorette might choose the sports car as offering greater value. Value as used here does not refer to which costs more. Instead, it is related to the perceived return on investment. Only in cases

where resources are unconstrained – a very unlikely scenario in the “real” world in which we live – does value reflect benefits absent consideration of resources consumed.

It is important to note that value is “in the eye of the beholder.” One individual or family will evaluate the value of a particular automobile differently than another individual or family. Parents may have different sets of criteria in determining value, as will the various children of the family. Similarly, organizations evaluate the value of the choices before them. However, while individuals make these decisions to support their self-interests, organizations must make decisions to maximize the value delivered to a much broader and potentially more diverse set of stakeholders.

Stakeholder interests in private sector companies must be considered and balanced as a whole, because many – sometimes in conflict with one another – can be key to the organization’s success. For example, shareholders seek a good return on their financial investment; customers seek value for money in the products or services they purchase; regulators seek compliance with laws and regulations; and employees seek competitive compensation, good working conditions, and potential for advancement.

However, as diverse as these various stakeholder interests may be, public sector stakeholders in government can be considerably greater in number and even more diverse. Public sector agencies seek to meet citizens and taxpayer expectations, meet the needs of beneficiaries of particular services, comply with guidance from legislative bodies, and respond to many other stakeholder demands. Moreover, stakeholders of a public sector entity can have very divergent interests and expectations, thereby resulting in very different perceptions of what constitutes “value.” Just a single government agency at any level (e.g., federal, regional, municipal), for example, may have to deal with multiple funding committees with very divergent interests and definitions of “value.” This makes the articulation of overall value for a government agency’s combined portfolio of products and services typically much more challenging in the public sector than in the private sector.

The authors reject the statement made by some employees in government who say, “We are not a business.” This is shortsighted. It is true that unlike commercial companies, public sector organizations cannot choose their customers and their goal is not to make a profit. But what else is different compared to a commercial company? Just like private sector organizations, government agencies and departments are responsible to attempt to optimize their resources and align them with the policies and strategies of their executive team, all with the purpose of best serving their citizens.