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SWP 21/90 PUBLIC SECTOR VENTURING

Mr KINGSLEY MANNING
Research Fellow at Imperial College Management School, and
Managing Director, Newchurch & Company
Porters North, 8 Crinan St
London
N1 9SQ

(Tel: 01 833 8899)

and

PROFESSOR SUE BIRLEY
Philip and Pauline Harris Professor of Entrepreneurship
Cranfield Entrepreneurship Research Centre
Cranfield School of Management
Cranfield, Bedford MK43 OAL

(Tel: 0234 751122)



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ABSTRACT

This paper examines the process of venturing in the public sector, a phenomenon which has its genesis in the United Kingdom, but which is beginning to emerge throughout Europe. Public sector venturing is defined as the process by which organisations currently operated by local or national government create and manage what are essentially new businesses. The authors argue that this is not simply a change of domain but rather major industrial re-structuring and, as such, is unparalleled in the experience of public service policy-makers. In essence, it will destroy the traditional divide between private sector services run by competitive firms and owned by shareholders, and public sector services populated by monopolistic organisations owned by the State. Whilst the federal structures which will emerge from the process will be better equipped to deal with the changing markets of the future, the authors question whether management will be able to develop the relevant skills within the timescales allowed by Government.

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Enterprise, entrepreneurship, and venturing are all terms which are concerned with the creation and development of business opportunities, activities which historically have been seen as the domain of the private sector. Venturing, in particular, has been seen as the "corporate" activity whereby large firms seek investments in small or new firms [NEDO 1986]. However, with the symbolic renaming of the Department of Trade and Industry as the Department for Enterprise, the British Government has signalled the creation of a new public/private hybrid strategy - public sector venturing.

In the United Kingdom, venturing in the public sector is increasingly playing a major role in the restructuring of whole industries and there are signs elsewhere in Europe as with privatisations, that other countries will follow suit. In the United Kingdom it has arisen as a response by the public service sector to an increase in both competitive and governmental pressure for change. However, this paper will argue that whilst many in the public service sector and in government believe that they are involved in the transfer of private sector skills to the public sector, in reality the public sector is engaged in developing venturing as a strategic process in a way which is unparalleled in the private sector.

VENTURING IN THE PRIVATE SECTOR :

Corporate venturing in the private sector has been defined as "the process of seeking, choosing, and managing any business opportunity which has potential for growth, but which is a departure from the company's core business, a new venture" [Birley, Manning and Norburn 1988]. As such, it has been primarily concerned with changes in the product-market domain of the firm, and with the development of new products, markets, or technologies in areas where the firm may have no specific competence. The aim is to find new ventures which will contribute to the long term survival and profitability of the firm. Thus it involves the creation of new, usually small, businesses as a way of exploring new product/market areas which may have potential for significant growth in the long term. These businesses may be "owned" by the parent company in a variety of ways - through a franchise, a license, a joint venture, as well as through a percentage of the equity.

Since new ventures are, by their nature, small relative to the rest of the organisation, they require a particular type of entrepreneurial management which is usually significantly different to that operated within large bureaucratic structures. In their study of the problems associated with the implementing of corporate venturing, Birley, Manning, and Norburn [1988] identified six key issues -

1. Corporate ventures require entrepreneurial skills to be developed by corporate employees. These are often difficult to find and to develop since operating on a

small scale, in an uncertain environment can be unattractive to corporate managers.

2. The level of uncertainty, the information base, and the protracted timescales usually require different decision rules to those operated within the rest of the organisation.
3. New ventures cannot be "drip-fed" cash and often require money which may be committed irrevocably.
4. The high degree of uncertainty in the early stages mean that planning must be based upon milestones, not timescales.
5. One of the advantages which a corporate venture has over other new ventures is its proximity to a rich resource base. However, the very nature of an entrepreneurial venture can militate against co-operation, isolating it from the resource base of the parent or firm.
6. Executives get better at creating and managing new ventures the more they do. Therefore, there is a further need to guard against isolation, and to create mechanisms whereby the managerial technology of new ventures is transferred to the parent organisation.

The issues described above require a different management style and process to that operated within the rest of the organisation. Confronting them is crucial to the success of venturing in the corporate sector. They are, however,

by executives with a track record of making commercial decisions - a scenario which does not describe the genesis of the public sector new venture.

THE DEVELOPMENT OF VENTURING IN THE PUBLIC SECTOR

The public sector in the United Kingdom derives from the political rationalisation and nationalisation of essential services during the first half of the century, services which have been controlled nationally and delivered to the community locally. They include, for example, the National Health Service, education, water, electricity, gas, transport [British Rail], and post and telecommunications [British Telecom]. In almost all cases, the organisations were created and managed by Government to provide services to the public whilst being sheltered from the market-place and from the forces of competition.

In recent years, however, there has been a radical change in Government policy, a change which was foreshadowed in the efforts made by the last Labour Government to restrict public spending, but which is most easily identified with the current Conservative Government, originally elected in 1979, and with its leader Margaret Thatcher, whose central ideology lies in the belief that the frontiers of the State must be rolled back. This change has also coincided with three other interlinked trends :

1. The age structure and the economic prosperity of the European population has been slowly changing over the past forty years to the point where, for example,

in Western Europe will be inherited by the generation now 40-50 years old from the generation which is now 60-70 years old" [Perlitz 1989]. By the year 2000, a large percentage of the population will be retired. The infrastructure of social services will not fit the demands placed upon them. For example, there will be a need for more hospitals and health care and fewer schools.

2. Rapid changing technologies mean that the optimum size of parts of an organisation has also changed. Highly expensive medical equipment cannot be left idle, and hospitals have been forced into new forms of intra-regional joint ventures. Computer controlled systems, require fewer people, can handle larger and more sophisticated data bases, can often replace large sections of reference libraries, and can be operated remotely.
3. Whilst many public sector services have been traditional monopolies, recent years have seen a growth in the provision of competitive products and services from within the private sector. This is not only confined to "public schools" [the strange British term for private sector schools run outside the control and the funding of the Department of Education and Science] and to private hospitals, many of which served a substantial overseas market, but also, for example, to commercial radio and television, to parcel delivery [through Federal Express], to the mail [through couriers] and to telephone services [through Air Call

These trends have awakened in the consumer increased demands for better and more sophisticated services, giving rise to additional and changing patterns of investment, a demand which Government feels both unable and ideologically unwilling to underpin. They arise at a time when the public service sector has also experienced increasing unrest within the ranks of its employees reflected in the increasing number of strikes in traditionally non-militant areas of, for example, hospital doctors, ambulance drivers, or university lecturers. Moreover, this unrest is not simply an explosion of impatience against relatively low pay rates. Whilst many are still dedicated to the idea of public service and are prepared to continue to contemplate lengthy careers on low salaries, a new generation of professional managers has been less willing to accept the penalties, not only in financial terms but also in the lack of freedom of operation.

It is within this context that recent legislative changes can be seen as a continuous process rather than single, unrelated events. They include, for example, the "simple" privatisations of ICL [1979], National Freight [1982], British Telecom [1984], Vickers Shipbuilding and Engineering [1986], British Airports Authority [1987] culminating in the more recent and complex 1987 Education Act which introduced the idea of autonomous local management of schools and polytechnics ; the 1988 Housing Act which encouraged the contracting-out of many municipal services; and the 1988 White Paper "Working for Patients"

Whilst each of these are concerned with the very different fields of education, housing, and health, they have a number of common threads which are running through the changes which Government is requiring from all public services:

1. In its strategic thinking, the sector is required to focus on the core service area, such as railways or postal services, to which they are dedicated. This means that they must reduce their involvement in the management of services or activities which are not directly related to the provision of that service. For example the requirement of regional health authorities to withdraw from the management of services not directly related to patient care.
2. Increased competition between units operating within the public sector, and between the public and private sector, is to be encouraged and stimulated. To this end, attempts have been made to enfranchise consumers so that market pressures can be brought to bear on the suppliers. For example, polytechnics which as from April 1 1989, have been removed from the control of local government, are now expected to compete openly for students. Moreover, this is in a market where the direct purchasing power of the student has also been increased through the direct fee structure.

3. The Government has been remarkably unspecific about the management approach to be adopted by the units operating in these service sectors. To a great extent, managers have been given both the encouragement and the freedom to develop a range of approaches, albeit within a defined framework.
4. There is to be an increase in the use of performance measures, both quantitative and qualitative. In many cases this will be enforced by the National Audit Office.
5. Participating units are to be given every encouragement to generate additional income wherever possible and beyond that which they have traditionally sourced from central or local government. Thus, for example, if it is to survive the only source of income for an academic institution will no longer simply be through student fees or through direct Government subvention.

The effect of these various pressures and forces is the creation of a new form of [corporate] venturing, a process which we term public sector venturing.

PUBLIC SECTOR VENTURING DEFINED

Public sector venturing is the process by which organisations currently operated by local or national government create and manage what are essentially new businesses, or new ventures. This goes beyond the simple process of privatisation whereby a self-contained unit,

shareholders through a stock exchange quotation. It includes the creation of new, self-governing organisations such as hospitals, schools, or polytechnics which have limited freedom to compete in the open market. Consequently, the managers of these new public sector ventures are faced with three, quite separate and, on the surface conflicting, objectives:

1. The reduction of the strategic domain so as to focus upon the core activities by shedding peripheral services. For example the sale of its computer service by a regional health authority.

In the process of setting up these new, independently managed units, managers have in some cases created completely new hybridised public/private structures, such as self governing trusts, and in other cases have used the more traditional mechanisms of employee buyouts, joint ventures, and trade sales to the private sector. For example, the sale by British Rail of its catering subsidiary to its employees.

2. The development of new income generating activities. To date the most popular route has been through joint ventures or licensing deals with either public or private sector organisations. In the case of joint ventures, the commonest approach has been for the private sector to provide long term development capital, and to rent the resulting facilities back to the public service sector. Arrangements can, however, be considerably more complex with both parties

assets provided by both. For example the building of a private hospital in the grounds of a National Health Service hospital, each having common services.

3. The creation of new, independent, competitive operating units. This is the area where the public sector differs most strikingly from the venturing in the private sector. The difference is one of scale. In the public sector, new ventures of considerable size are being created out of mature operating units already employing hundreds or thousands of people. For example, a typical seed corn investment in the private sector would be of the order of £0.5m - £1m; the average management buyout price is less than £2m. In the public sector, a new venture such a self-governing hospital will almost certainly have a turnover in excess of £20m; and a relatively modest management buyout will have a turnover in excess of £5m.

THE IMPLICATIONS OF PUBLIC SECTOR VENTURING

Clearly the changes described above are complex. They are not simply a change of domain, but rather part of a massive process of industrial restructuring. This is unparalleled in the experience of public service policy-makers and managers who are being asked both to take on competitive approaches to the provision of their services so as to attract additional "customers" in the form of students or patients, and to use new and unfamiliar venturing mechanisms. Consequently, the issues facing the public sector manager are very different from those facing the

* It is essential that the "new" ventures which are created within the public sector continue to have a continuing relationship with the core business. So, for example, the major customer of a building maintenance business, sold to its employees by a local municipal authority, will remain the local authority. In the private sector, the very nature of the new venture is such that the product or service is peripheral or relatively unimportant to the originating organisation.

* The management skills of those facing the task of creating new ventures within the public sector, for whom the experience is often entirely new, are often, and inherently, incomplete. In particular, there are few skilled in the fields of finance, accounting, commercial marketing, or selling since in monopolistic organisations they have hardly been necessary. Moreover, the resource base within the organisation has not been set up to provide the relevant information. For example, until April 1, 1989, almost all the accounting, for polytechnics took place outside the institution and within local government. As a result, no real in-house management information systems existed.

In the private sector, these skills are a normal part of commercial life. Indeed, the presence of a balanced management team for a new venture is a

investors, both corporate and institutional. This is particularly so in the very popular management buyout, a mechanism which is similar in many ways to the new ventures which are being created in the public sector. Yet in the public sector, the speed of change is so rapid that new ventures are being created, and management with appropriate skills are being sought after the strategic decision has been made and during the implementation process.

This lack of skill and experience has a further implication for the public sector. Quite simply, the venturing process, the creation of new ventures, is not understood by any of the parties involved. Thus, both the managers who are attempting to create the new venture, and those who are responsible for judging its strategic relevance and its viability are ill-equipped. Managers in the private sector start with a better skill base, and are already further down the venturing learning curve.

- * The public sector is highly unionised, and the trade unions are a powerful component in managerial decisions. Consequently, they must be involved in a sustained and continuous process of consultation throughout the creation of the new venture. By contrast, venturing in the private sector rarely has to involve trade

unions. Even in the event of a major management buyout, trade unions have been passive observers of the process of negotiation, although many have subsequently participated in the ownership of the new firm through the purchase of equity.

* The framework of regulation within which the public sector venture must operate is far more complex than that for the private sector. For example there are complex rules for introducing private sector capital into public sector projects. Perhaps it is fortuitous, therefore, that managers in the public sector, by the very nature of their civil service backgrounds, are far better equipped to deal with complex regulatory frameworks than their private sector counterparts.

* Once the new venture is established, the public sector manager must make major changes in the ways in which he approach every day operational decisions. This goes beyond questions of finance or marketing to encompass the ways in which he manages all the assets both physical and human. For example, a new venture requires support and involvement from all levels in the organisation. Yet the very way in which it has been created means that it is often seen as a threat to job security. In the private sector, venturing is now seen as exciting, a logical extension of

CONCLUSION

It is clear that venturing in the public sector is not new, nor is it confined to the United Kingdom. Portugal started a privatisation programme in 1988 with the state banking, brewing, insurance, and petro-chemical firms in the first group; Spain has created a new independent regulatory authority to supervise three new private television channels and to break the state monopoly; the Egyptian Government has sold a number of state owned hotels; in Mexico, the Partido Revolucionario Institucional has liquidated more than 50 state owned enterprises; in 1986, the Japanese Government floated Nippon Telephone and Telegraph; and in 1988 Kenya sold part of the equity of its Commercial Bank [Hyman 1989].

Moreover, public sector venturing is not simply a matter of transferring well known and well understood private sector entrepreneurial skills and practices. It is different in scale, in context, in timescale, in the mechanisms which are legally permitted, and in the available skills.

Moreover, it destroys the traditional divide between public and private sector services whereby the public sector was populated by monopolistic organisations "owned" by the State, and the private sector by competitive firms owned by shareholders through equity. In the future, these boundaries will be increasingly blurred as hybrid public/private sector organisations are created.

Increasingly, private capital will be used to meet public sector objectives; and public sector organisations will operate as private sector firms. The resultant diverse

businesses where the boundaries of ownership and control will be ill-defined. The federal structures which will emerge will be better equipped to meet the complex strategic and operational requirements. That is, assuming that management is able to develop the relevant skills, and Government is sufficiently patient.

For those concerned either as practitioners, or as advisers, the challenge is to re-consider many traditional, axiomatic concepts of strategic management. Founded on a clear definition, of public and private sector, of profit and non-profitmaking organisations, and based on comparatively simplistic notions of corporate ownership, such concepts will not prove directly applicable or helpful to the new generation of public sector ventures. Furthermore, in breaking down the hitherto rigid boundaries of large scale organisations, and in meeting some of the changing economic, demographic, and cultural demands of the 1990s, public sector venturing may represent an important example which large, private organisations might one day seek to emulate.

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