

WHY RADICAL INNOVATION IS NEEDED  
TO REINVENT PUBLIC SERVICES FOR  
THE RECESSION AND BEYOND

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# THE INNOVATION IMPERATIVE

MICHAEL HARRIS AND DAVID ALBURY

**NESTA**

1 Plough Place  
London EC4A 1DE  
[research@nesta.org.uk](mailto:research@nesta.org.uk)

[www.nesta.org.uk](http://www.nesta.org.uk)

[www.nestalab.org.uk](http://www.nestalab.org.uk)

NESTA is the National Endowment  
for Science, Technology and the Arts.

Our aim is to transform the UK's  
capacity for innovation. We invest  
in early-stage companies, inform  
innovation policy and encourage  
a culture that helps innovation  
to flourish.

# THE INNOVATION IMPERATIVE

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WHY RADICAL INNOVATION IS NEEDED TO REINVENT PUBLIC SERVICES FOR THE RECESSION AND BEYOND

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**The challenges we face**  
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We face seemingly intractable long-term economic and social challenges, which are being exacerbated by the recession. Despite the current constraints, radical innovation is needed in public services to respond effectively to these challenges.

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Radical new approaches require radical new actors. We need to combine the ingenuity and initiative of a diverse group of innovators – from the public sector, private companies and third sector, alongside users and communities – to find new solutions to pressing economic and social problems.

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We need a new way of innovating in public services – a rigorous experimentation, focused on major challenges, and which encourages and embraces local solutions.

# EXECUTIVE SUMMARY

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To talk of the current economic crisis creating ‘opportunities’ for innovation – while thousands of people are losing their jobs and public services face massive cuts – might appear crass and naïve. Instead, the recession makes radical innovation in our public services a necessity, because without bold new approaches our public services will be over-stretched by the short-term demands of the downturn and overwhelmed by the long-term challenges of the future.

The public services we require will have to deliver significantly better performance at significantly lower cost. The choice before us is simple in form but complex in reality. We can emerge from the recession having deferred imaginative responses to the major economic and social challenges we face and with a weaker collective capacity for innovation – or we can respond by putting innovation to work to meet these challenges now, supported by a more systematic and robust approach to innovation in public services.

To achieve the latter, we need a new way of innovating in our public services – a rigorous experimentation which encourages and embraces local solutions. We need to bring together the range of innovators who are already at the forefront of finding new solutions, across the public sector, private companies and social enterprises. Most crucially, we need to put users, consumers and citizens at the heart of innovation in public services as never before, as a force for change and as partners in designing and delivering services. And we need to strengthen the methods by which we discover, develop, and diffuse innovations – including a greater capacity outside of existing organisations to support great ideas from inspiration to implementation.

### **Accelerating innovation in public services is a vital part of attacking the recession**

In NESTA's first policy paper on innovation and the economic downturn, we stated that the UK needed a strategy to 'attack the recession', not just respond to it – and that this includes innovation in public services. This policy paper develops this argument and examines:

- why innovation in public services is even more important in the downturn;
- how bringing together a diverse group of innovators who are already responding to economic and social challenges is crucial to reinventing public services; and
- what we need to do to harness the potential of innovation to see us through the recession and provide responses to the major challenges we face.

### **We face seemingly intractable economic and social challenges**

Some of these challenges are increasingly present: an ageing society; a rise in long-term debilitating health conditions; environmental degradation and climate change. Consider the following:

- By 2025, half the UK adult population will be aged 50 and over. The unemployment rate of those aged between 50 and the state pension age is already much higher than for the rest of the working population, at more than 30 per cent. The total cost of an ageing society by 2025 can be estimated at more than £300 billion a year.
- More than a quarter of 50-64 year-olds have a long-term health condition or disability, and by 2025 more than six million older people will suffer from long-term illness. On present trends, obesity could cost half of the current NHS budget by 2050, some £49.9 billion.
- We are edging ever-closer to a crucial tipping point at which global climate change as a result of rising levels of greenhouse gases could become irreversible, costing the world economy approaching \$2 trillion in lost output.

### **We can't postpone facing these challenges any longer**

The cost of deferring action to confront these challenges is beginning to rise – and could easily outpace our ability to respond. Imagine the following scenarios:

- An aged society, with bankrupt and decrepit social care services and empty private pension funds, causing tensions between generations and a crisis of legitimacy for the state.
- A society in which millions of people are incapacitated by long-term health conditions due to increasing obesity, alcohol and drug abuse, and stress – placing an ever-greater burden on an overwhelmed and rationed National Health Service.
- A depleted environment, leading to 'resource wars' as people and nations struggle to control safe habitats and clean water.

### **We need to respond with radical new approaches**

Our existing approaches and institutions are inadequate for these challenges. We need bold new services and programmes which are better targeted at root causes and which are better designed to resolve or at least ameliorate them. This is the only route to significantly better outcomes at significantly lower cost.

### **Yet the recession will also constrain our ability to develop new approaches**

Developing new approaches to these challenges would be tough enough in easier times, but the recession will make it much more difficult. Firstly, the recession is exacerbating many of these major challenges, increasing the demand on existing services. For example:

- Rising joblessness is impacting negatively on health and wellbeing, causing greater rates of family breakdown and depression.
- Crime and anti-social behaviour are rising.
- The recession is wiping hundreds of billions of pounds from pension funds.

Secondly, the pressure on public finances caused by the recession is likely to lead to nearly £40 billion in reduced funding in the next few years, which will impact on the charities, voluntary groups and private sector companies that deliver public services, as well as the public sector itself.

### **As a result, the recession could set back effective responses to these challenges for a generation**

These twin pressures – greater challenges and constrained resources – could defer the development of new approaches to these challenges for many years. Public policymakers could, understandably, focus on relatively limited efficiencies when what we need is a longer-term agenda for much greater value for money. Private companies could retrench into existing products and processes rather than develop new customers and markets. The third sector could scabble around for survival at the cost of serving needs and ensuring its sustainability.

### **Instead, we need to recognise that the recession demands radical new approaches**

In one sense, the deeper the 'crisis', the more we are forced to recognise the necessity of radical approaches. Reducing budgets for public services by a few per cent here or there won't restore public finances to a more stable condition, let alone reinvent public services in ways that will enable them to respond to the challenges we face. Crisis has often spurred change in the past; we need to ensure that it does so again.

**Radical new approaches require radical new actors**

We need to combine the ingenuity and initiative of a diverse group of innovators – whether from the public sector, private companies or social enterprises – who are already at the forefront of finding new solutions to pressing economic and social problems. But, most crucially, we need to put users, consumers and citizens at the heart of innovation in public services as never before, as a way of driving change and organising the delivery of services. In a context where resources will be limited, these groups are invaluable assets, not only for innovation, but for a fundamentally different future: where services are increasingly responsive to needs because the public is directly involved in how they are organised and delivered.

**We need a new way of innovating in public services**

Government should ensure that innovation in public services is central to our response to the recession and beyond. But this should not mean simply continuing the important but somewhat incremental progress that has been made so far. Many of our current approaches to innovation are no longer fit-for-purpose; they are often too costly; they exclude the wider community of innovators (including professionals and frontline workers within existing services); they lack a disciplined set of methods; and they are insufficiently focused on the major challenges we face. Further, as is widely recognised, some of the mechanisms that we have relied on to drive improvement in public services, such as inspection and audits of performance, require reform so that they are better designed to support rather than subdue innovation.

Instead, we need a rigorous experimentation for innovation in public services – focused on major challenges – which also encourages and embraces local solutions. We need to bring together the innovators who are already at the forefront of finding new solutions in the public sector, private companies and social enterprises. We need to strengthen the voice of citizens, and engage them in service design and delivery. And we need to strengthen the methods by which we discover, develop, and diffuse innovations – including a greater capacity outside of existing organisations to support great ideas from inspiration to implementation.

**Recommendations****Promote and support innovation in central government:**

- Major government departments, including in UK central government and devolved governments, should each designate at least 1 per cent of their budgets to a departmental fund for innovation. This would create a resource for innovation across UK central government alone (excluding defence) of £2.7 billion, supporting both existing and new projects.
- As part of this effort, government should create cross-departmental ‘challenge funds’ in areas such as an ageing society, wellbeing, services for young people, and offending, and involve participants from outside of government – including users – to review proposals for funding and challenge existing barriers to innovation.
- Ministers and civil servants should accelerate support for innovation through procurement, including enabling smaller, less established but potentially more innovative organisations (including social enterprises) to become providers.

**Create stronger incentives for the development and adoption of local solutions:**

- Resources can be freed up for local innovation by downgrading and re-shaping large-scale, centrally driven public sector IT projects, radically reducing the number of targets for public services, and streamlining audit and inspection regimes for public services accordingly.
- Some of the resources saved should be shifted to providers (such as local government and health authorities) to commission advice and expertise from organisations that support local innovation. A mechanism for this might be in the form of ‘innovation credits’ given to providers.
- Every public service organisation should be granted the right to innovate unless it is explicitly removed from them (for reasons of unusual political accountability or poor performance). This would help to send a strong signal of cultural change in public services.

### Open up innovation in public services to a wider set of actors:

- Require public sector commissioners to develop new markets for public service delivery, particularly for a wider range of providers. In some cases, this will mean breaking contracts down into smaller lots to encourage smaller providers; in others, it will mean larger contracts that cross several traditional service 'silos' (such as mental health care, housing and employment services). In both cases, commissioning for innovation is crucial; a stronger articulation of the outcomes being sought should encourage organisations and people to come together in new ways to deliver these outcomes.
- Put citizens at the heart of services – in the short term by basing commissioning decisions on a better understanding of user needs, and over time by involving users in the design and delivery of services.
- Create and support local Social Innovation Zones. These zones would be supported by devolved budgets, so that communities can devise integrated and creative responses to the downturn, bringing together employment, training, education, business creation, social enterprise, culture and regeneration.
- Strengthen 'intermediary organisations'. With a greater emphasis on local innovation and a wider range of actors must come a greater capacity to learn in a robust and disciplined way about what works, and to diffuse innovations more widely, more quickly – hence the importance of organisations and networks that can perform this role.

### The Lab: innovating public services

The Lab is NESTA's response to this need for bold new ideas in the face of major economic and social challenges. By bringing together experience and ingenuity from across the public, private and third sectors, and drawing on the insights of citizens and consumers, the Lab plays a vital role in making public services fit for the 21st century.

The Lab provides the freedom, flexible capital and expertise to undertake radical experiments. It tests out new ways of finding and spreading the best ideas – this might be by running a challenge prize, building a social ventures incubator, or creating powerful new teams of users, front-line staff and decision-makers.

The Lab is not a physical space or an institution – it's a series of practical projects, informed by research and delivered in partnership with those that run and use our public services. It shares lessons about what works – and what doesn't – and creates opportunities for people to solve problems together.

The Lab's success will be measured in two ways. First, has it contributed to the development of better services – and in these challenging economic times, has it found ways of delivering better for less? Second, have its methods and approaches been adopted by others to improve people's lives.

The Lab is a much-needed facility dedicated to testing radical new responses to some of the UK's most pressing social and economic challenges.

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### About NESTA

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NESTA is a unique and independent body with a mission to make the UK more innovative. We do this because we believe innovation is vital to the UK's economic competitiveness and ability to respond to major social challenges. We invest in early-stage companies, inform and shape policy, and deliver practical programmes that inspire and equip others to solve the big challenges of the future.

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# THE CHALLENGES WE FACE

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We face seemingly intractable long-term economic and social challenges, which are being exacerbated by the recession. Despite the current constraints, radical innovation is needed in public services to respond effectively to these challenges.



We face seemingly intractable social challenges. Some of these challenges are increasingly present, though they represent long-term trends, such as: an ageing society; a rise in long-term debilitating health conditions; and environmental degradation and climate change.

### Examples of emerging economic and social challenges

#### – An ageing society:

By 2025, half the UK adult population will be aged 50 and over.<sup>1</sup> This profound demographic shift will increase the numbers of people affected by poverty, ill-health and unemployment.

Already, 2.2 million people – more than one in five pensioners – live below the poverty line.<sup>2</sup> Twelve million people, or half the UK workforce, are putting nothing aside for old age.<sup>3</sup> The unemployment rate of those aged between 50 and the state pension age is much higher than for the rest of the working population (at more than 30 per cent),<sup>4</sup> and almost half of recipients of Incapacity Benefit are aged between 50 and state pension age.<sup>5</sup>

#### – A rise in long-term health conditions:

By 2025 more than six million older people will be suffering from a long-term illness.<sup>6</sup> Chronic diseases such as coronary heart disease, strokes and diabetes cost the UK £12 billion a year in disease management and lost earnings, a figure predicted to increase by 30 per cent by 2025 to a minimum of £15.6 billion.<sup>7</sup> Chronic disease includes chronic obstructive pulmonary disease (COPD). On present trends, obesity could cost the NHS £6.3 billion by 2015,<sup>8</sup> half of the current NHS budget by 2050 (£49.9 billion),<sup>9</sup> and incalculable additional costs for other public services (for example, social services for house-bound people suffering from associated conditions and illnesses such as arthritis, heart disease and diabetes).

#### – An increasingly degraded environment:

The Intergovernmental Panel on Climate Change has concluded that temperatures could rise by more than one degree this century mainly as a result of rising levels of greenhouse gases such as carbon dioxide (CO<sub>2</sub>) in the atmosphere – ever-closer to a critical point that could trigger the irreversible melting of the Greenland ice sheet and the collapse of the Amazon rainforest.<sup>10</sup> This directly threatens the UK; for example, the Thames barrier – which protects 1.25 million people and £80 billion worth of buildings and capital infrastructure – was built when average sea levels were rising by 1.8 mm a year, compared to 3.1 mm a year today.

Other challenges are persistent but no less significant, such as: retaining global economic competitiveness; disparities in social opportunity, educational achievement, and health and wellbeing; crime and social disorder; alcohol and drug abuse; and developing resilient and diversified local economies.

### Examples of persistent economic and social challenges

#### – Economic competitiveness:

The UK will need to improve its skills base to build a comparative advantage in the high-skill, high-wage economy that will drive future prosperity, yet more than one-third of adults in the UK do not have a basic school-leaving qualification and five million people have no qualifications at all.<sup>11</sup> Further, 189,500 (9.4 per cent) of 16-18 year-olds are not in education, employment or training (NEET).<sup>12</sup> The UK's productivity remains below that of countries such as Germany, France and the US, due in large part to weaker skills and poor management practices.<sup>13</sup>

#### – Social inequalities:

The gap between the richest and poorest in the UK appears to have widened over the past ten years, with negative implications for social cohesion.<sup>14</sup> The number of children in poverty stood at 2.9 million in 2006–07.<sup>15</sup> Child poverty costs the UK economy £25 billion each year, in the demands on public services but also the reduced GDP as a result of under-educated young people.<sup>16</sup> Such inequalities also have major impacts later in life; men working in unskilled and semi-skilled manual jobs report levels of ill health in their 50s not experienced by professional and managerial men until their 70s.<sup>17</sup>

#### – Mental ill-health:

One in ten 5-16 year olds now has clinically significant mental health difficulties – ranging from anxiety, depression, over activity, inattentiveness (ADHD) and anorexia – through to conduct disorders such as uncontrollable or destructive behaviour.<sup>18</sup> The overall cost of mental health problems in the UK is estimated at more than £110 billion a year.<sup>19</sup>

#### – Crime and social disorder:

Re-offending costs UK society £13 billion in the criminal justice system and beyond.<sup>20</sup> More than 55 per cent of prisoners who return to the community are reconvicted within two years.<sup>21</sup>

#### – Alcohol and drug abuse:

The estimated costs of alcohol misuse in England alone are around £20 billion, covering healthcare, alcohol-related crime, reduced workplace productivity and the wider economy costs.<sup>22</sup>

In addition to these specific challenges, there are even broader factors that are likely to shape demand over the next 10-15 years for public services in particular, such as changes to family structures and household organisation (especially the increase in single-person households), the internet, and the movement of labour between regions and nations.<sup>23</sup>

### **We can't postpone facing these challenges any longer**

Or rather, we increasingly recognise that the cost of deferring concerted action to confront these challenges is beginning to rise – and could easily outpace our ability to respond. Despite the cost and commitment required, it is cheaper and easier to respond to these challenges now than to wait. This is apparent at the macroeconomic level and at the level of individual innovations.

### **Selected costs of postponing responses to major challenges**

- The Stern Review in 2006 demonstrated the massive economic cost of failing to respond to climate change.<sup>24</sup> Reducing carbon emissions by three-quarters by 2050 would cost around 1 per cent of GDP, whereas a rise in temperature of two to three degrees Celsius would reduce global economic output by as much as 3 per cent (approaching \$2 trillion in lost output).
- The combined costs of an ageing society – assuming no significant reform or innovation – can be estimated at more than £300 billion by 2025, as a result of rising costs in areas such as social care, long-term health conditions, pensions and benefits.<sup>25</sup> To put this in context, this is around three times what we currently spend on the NHS.
- One analysis has estimated that it costs ten times more to absorb the total costs of child poverty to the UK in reduced productivity, economic output, higher crime and poorer health than it would to eradicate the problem through new programmes.<sup>26</sup>
- The use of prison has risen sharply since 1992 (mainly as a result of increased penalties for offences), and the prison system costs more than £2 billion across the UK. It has been estimated that one type of preventative scheme alone could save the taxpayer more than £300 million each year,<sup>27</sup> but in 2007-08, out of the entire prison population of England and Wales (nearly 73,000), only 7,997 prisoners completed programmes in prison that are accredited as effective in reducing re-offending (with another 7,412 in drug treatment programmes).<sup>28</sup>
- Similarly, costs associated with mental ill-health (£110 billion a year and rising) demand a more preventative approach which would yield huge long-term benefits to the economy as well as individuals, as a result of reduced costs for healthcare, unemployment and workplace absence, and crime. The total benefits for a one-year cohort of children in the UK from a preventative approach have been estimated as £5.25 billion, and for the population as a whole as £23.6 billion.<sup>31</sup>

If we do not take concerted action in response to such challenges, it is possible to envisage a range of extremely negative scenarios in the future:

- In an aged society, we could face bankrupt and decrepit public services, empty private pension funds, a crisis of legitimacy for public services and the state, widespread social division and generational tension as a result of the higher dependency ratio of working taxpayers to pensioners.
- A society in which millions of people are incapacitated by long-term health conditions due to increased obesity, alcohol and drug abuse, and stress – and an overwhelmed and rationed National Health Service.
- A depleted environment, leading to ‘resource wars’ as people and nations struggle to control safe habitats and clean water.

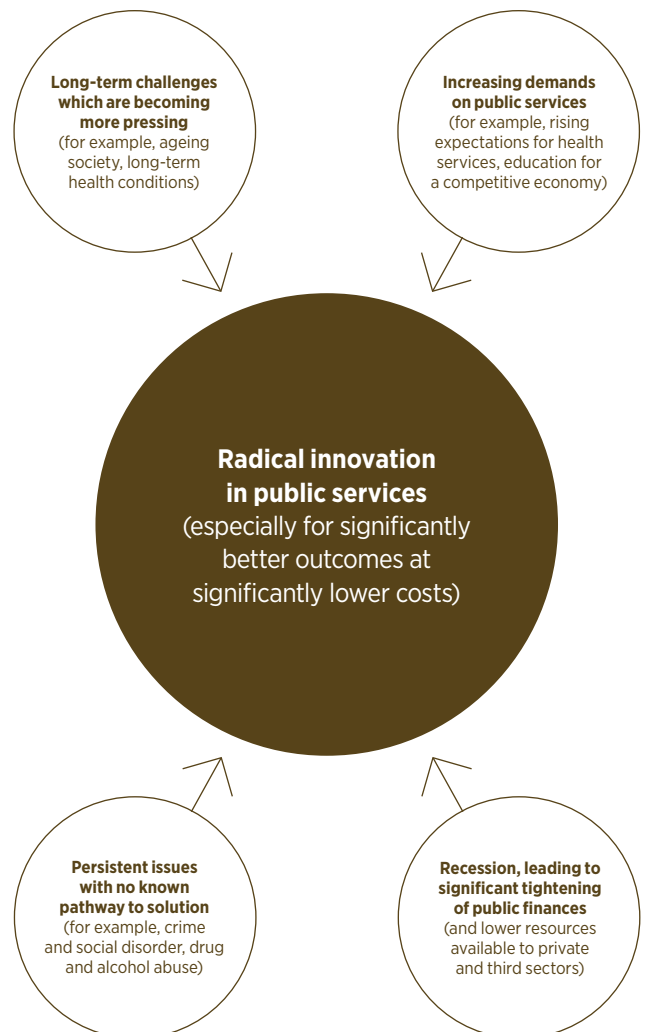
Collectively, these trends and conditions are creating an unprecedented requirement for radical innovation in public services, as illustrated in Figure 1.

#### **We need to respond with radical new approaches**

Our existing approaches and institutions are inadequate for these challenges. If we defer action, they will be overwhelmed by the costs of complacency. New approaches are needed – services and initiatives which are better targeted at the root causes of these challenges and which are better designed to resolve or at least ameliorate them. This is the only route to significantly better outcomes at significantly lower cost – whether provided by the public, private or voluntary sectors.

More fundamentally, our existing approaches and institutions are also inadequate because, in the main, they lack the capacity to develop the new approaches we need. This goes beyond public sector bureaucracies; any organisation or system is susceptible to ‘lock-in’, whereby it loses the ability to develop novel ways to serve its customers or clients because it has invested so heavily in its existing processes and technologies.<sup>30</sup> (This is akin to the ‘innovator’s dilemma’, which describes how a company’s capabilities can become obstacles in the face of changing markets and technologies.)<sup>31</sup> This also explains why novel approaches are often developed by new market entrants: they are freer to do so. Such is the case with new approaches to major economic and social challenges (as noted further in section 2).

**Figure 1: Major factors in the need for radical innovation in public services**



### Examples of radical innovation in public services

#### – Open University:

The Open University was the world's first successful distance teaching university. More than 180,000 people are currently studying with the university, making it the largest higher education institution in the UK. In 1926, the educationalist and historian J. C. Stobart wrote a memo while at the BBC, advocating a 'wireless university'. By the early 1960s there had been a range of proposals for combining broadcast lectures with correspondence and visits to universities. In 1962, Michael Young proposed 'an Open University' to prepare people for external degrees of London University, while the BBC and the Ministry of Education were discussing plans for a 'College of the Air'. The following year, a Labour Party study group proposed a 'University of the Air' using radio and television. Jennie Lee, Minister for the Arts in the Wilson Government, developed this recommendation in office. In January 1971, the first students began work on the first foundation courses offered by the new university.

#### – Hospices and palliative care:

Hospice care has changed the way people faced with a terminal illness and those close to them are treated – relieving pain and supporting them physically, emotionally and spiritually. A quarter of a million patients are cared for by hospices in the UK each year, either in a hospice or in their own home. In the nineteenth century there was a great expansion in hospital building, but this in effect marginalised those at the end of life whose condition was incurable and who might be viewed as medical 'failures'. In response, charities established special institutions, some of them called hospices, to provide care and sanctuary to those nearing death. In 1967, Cicely Saunders, the acknowledged founder of the modern hospice movement, established St Christopher's Hospice in South London; it became a centre of excellence in a new field of care – a positive and imaginative approach to caring up to the end of life – and the stimulus for the growth of hospices in the UK and around the world.

#### – Connected Care from Turning Point:

This is a model for significant change in how health, housing and social care services are provided. The concept originated from research carried out by Turning Point, in conjunction with the Institute for Public Policy Research in 2004, which found that people with the most complex

needs are often failed by health and social care services. Connected Care integrates health, housing and social care in the most deprived communities, with the community playing a central role in the design and delivery of those services. It provides a framework to help commissioners provide integrated services that meet the needs of individuals, enables local people to design and deliver their own services, and achieves greater diversity of provision and draw upon the strengths of the third sector.

### The recession is exacerbating many major challenges

The recession is exacerbating many of these challenges, both those which are increasingly present and those which are persistent.

#### Examples of how the recession exacerbates major challenges

- Rising joblessness will impact negatively on health and wellbeing, given that employment and socio-economic status are the main factors causing social differences in physical and mental health and mortality.<sup>32</sup> The number of homes repossessed by lenders rose by 54 per cent in 2008 to 40,000; one in 64 mortgages ended 2008 2.5 per cent or more in arrears.<sup>33</sup> Repossessions in 2009 are expected to reach 75,000.
- The economic downturn has already wiped significant value from pension funds (£157 billion by November 2008, a fall of almost a third).<sup>34</sup> One in 12 people is considering pausing their pension payments in order to offset the increased cost of living or rising unemployment; this would equate to a £35 billion reduction in total UK retirement savings (or £1,047 less per year per person in the value of annuity payouts).<sup>35</sup>
- The recession will obviously harm UK competitiveness and in particular new business formation. There has been a 17 per cent decline in the number of new registrations in the past twelve months, equating to nearly 80,000 fewer businesses – almost twice the drop seen in the last recession in the early 1990s.<sup>36</sup> There is an acute lack of credit for new and existing businesses. Training provided by firms will also be hit, and the unemployed will struggle to keep their skills up-to-date.
- Crime often rises in economic downturns, in particular 'acquisitive crime' such as car break-ins and home burglaries; for example, there was a

19 per cent increase in violent crime in the recession of the early 1990s. The most recent data from the British Crime Survey reveals a 4 per cent rise in domestic burglary, a 16 per cent increase in fraud and forgery and an 18 per cent rise in street robberies committed at knifepoint.<sup>37</sup>

- There may also be further long term effects of the recession on the state of society. More than one in ten people suffers relationship problems as a result of debt concerns. Since debt and insolvency concerns are on the rise, family breakdown and the resulting effects are also likely to increase.<sup>38</sup> There has already been a rise in home repossessions by 70 per cent, which could see five million people waiting for a council house by 2010.<sup>39</sup>
- The Rowntree Foundation has predicted that the Government's target of halving child poverty by 2010 has been put at serious risk by the recession, in part due to welfare-to-work schemes not being able to provide sufficient jobs for parents of children in poverty.<sup>40</sup>
- Finally, the recession is threatening both public and private investment in new energy technologies and schemes. Any decline in public investment could threaten the UK's ability to meet its target to cut greenhouse gas emissions by 80 per cent by 2050,<sup>41</sup> and there are predictions of zero growth for 2008-2009 in investment in clean technology companies (compared to 60 per cent in the year before).<sup>42</sup>

### **The recession will also constrain our ability to develop new approaches**

Developing new approaches to these challenges – and in doing so re-evaluating and reforming our current institutions and systems – would be difficult enough in easier times. In any circumstances, it would require significant resource and long-term commitment; in the current context, it has become much harder.

Firstly, and understandably, the recession has focused attention on the immediate and the short-term in both the private and public sector – from the latest failed firm to the increasing strain on public services. 'Innovation' sounds like a luxury; the priority is coping, survival.<sup>43</sup>

Current services will be stretched, in particular, welfare services. Nine in ten local authorities have or expect additional demands on services; 53 per cent are already experiencing additional demands on welfare and debt advice services, and 45 per cent in additional housing benefits applications.<sup>44</sup>

There is much more to come; spending on welfare currently represents about 24 per cent of all public spending, but in the recession of the early 1990s it reached 29 per cent.<sup>45</sup> Spending on benefits is estimated to have risen by 1.83 per cent between 2008 and 2009 and is predicted to increase further by 0.92 per cent and 1.21 per cent in 2009-10 and 2010-2011 respectively to a total of £130.44 billion by the end of 2011.<sup>46</sup>

Secondly, in the longer-term, the recession will erode the capacity to develop new approaches. Much of the public sector will face significantly constrained resources – a consequence of lower receipts from taxation and a marked increase in public debt. The Government has forecast that spending on public services will be £22 billion lower in 2013-14 compared to the spending levels announced in the Budget in March 2008;<sup>47</sup> total public spending will be £37 billion lower over the period 2011-2014 compared to the levels set-out in the Comprehensive Spending Review in 2007, according to the Institute for Fiscal Studies.<sup>48</sup>

However, the downturn has deepened since these forecasts were made. The CBI has predicted that the UK economy will contract by 3.3 per cent in 2009 (4.5 per cent since the recession officially began in October 2008), and that unemployment will peak at just over 3 million (9.6 per cent) in the second quarter of 2010.<sup>49</sup> GDP growth for 2009 has been revised down from -1.7 per cent in November to -3.3 per cent; there will be zero growth in 2010.<sup>50</sup> Tax receipts have fallen at a faster rate than expected – down £6.7 billion (11 per cent) in January 2009 compared to the same month in 2008.<sup>51</sup>

As a result, analysis by the Institute for Fiscal Studies suggests that an additional £20 billion of higher taxes or lower spending will need to be implemented by the end of the next Parliament to achieve the improvement in public finances set out in the Pre-Budget Report in November 2008.<sup>52</sup> (For comparison, £20 billion is just under a fifth of the annual NHS budget or just under a quarter of the total education budget.)

At the same time, public support for increased government spending is falling. There is no longer majority support for more tax and spending on health, education and other public services.<sup>53</sup> For the first time since 1984, more people want spending for public services to be left broadly where it is, rather than increased. (As suggested, neither of these options is likely to be available in the longer-term).

Further, the macroeconomic context is reducing the resources available to government in other ways; for example, due to inflation in 2007-08, the funding awarded to local councils in England and Wales in the Comprehensive Spending Review in 2007 is now worth almost £500 million a year less in real terms than the Government intended.<sup>54</sup> Further, councils have been affected by increases in fuel and energy prices

(amounting to £375 million), rising food prices (for example, for school meals and catering for the elderly and disabled), a fall in income as the housing market slumps and developments stall, and a significant increase in demand for social housing. As a result, the Local Government Association has calculated that town halls will have to find more than a billion pounds in savings over the next three years.<sup>55</sup> One in seven councils has already made redundancies as a result of the recession.<sup>56</sup> Eighty-five per cent of councils think that the recession will make it more difficult to achieve Local Area Agreement targets, particularly in issues such as housing and employment/skills.<sup>57</sup>

UK central Government seems confident that the final conclusions of its Operational Efficiency Programme and Public Value Programme – two programmes launched in the 2008 Budget to identify potential efficiency savings in public spending and service provision – will find sufficient savings for public services to be expanded and improved over the next Spending Review period.<sup>58</sup> However, given these efficiency savings, and with an extra £5 billion expected for 2010-11 (as announced in the Pre-Budget Report in November 2008), it might become increasingly difficult to find and root out further inefficiencies – at least by using existing approaches.

The private sector is experiencing its own version of this crunch. The CBI has forecast that investment by businesses will shrink by 9.2 per cent in 2009 and 1.7 per cent in 2010.<sup>59</sup> This is likely to reduce the private sector's ability to develop new products, technologies and services for public services, and its propensity to accept new responsibilities, for example, regulations relating to environmental sustainability and climate change.

Similarly, the third sector – voluntary and community groups, social enterprises, charities, cooperatives and mutuals – is suffering from decreased financial resources at the same time as demand for services increases. The third sector is a vital source of new approaches as well as a provider of existing services.

In October 2008, 38 per cent of charities reported that they have been affected by the economic downturn, through higher costs and lower donations – a figure likely to have increased markedly since then.<sup>60</sup> At least one in 12 charities will be forced to make redundancies.<sup>61</sup> Nearly 20 per cent of charities have been unable to get funding for new services or people; 16 per cent have been unable to get funding to maintain ongoing services.<sup>62</sup> The National Council for Voluntary Organisations estimates a shortfall in charities' funding of £100 million.<sup>63</sup>

The pressure is likely to deepen with the recession, especially with any reductions in public spending. Many third sector organisations are increasingly dependent on payments from the state for providing services; for

example, organisations which deliver employment and training services now earn more than 80 per cent of their income from the state, followed by those in housing (66 per cent) and social services (60 per cent).<sup>64</sup> The National Council for Voluntary Organisations estimates that about 100,000 third sector organisations do not have sufficient funds to cover 12 months' operations; in the employment and training sector the average is less than six months' reserves.<sup>65</sup>

Further, the general economic climate has affected investment in some sectors particularly harshly. For example, 60 per cent of the regeneration sector has reduced its activity by half in the last 12 months, in line with the general downturn in the housing market.<sup>66</sup>

### **The recession could set back effective responses to these challenges for a generation**

These twin pressures – greater challenges and constrained resources – could defer the development of new approaches to these challenges for many years. Public policymakers could, understandably, focus on relatively limited efficiencies when what we need is a longer-term agenda for much greater value for money.<sup>67</sup> Private companies could retrench into existing products and processes rather than develop new customer and markets. The third sector could scabble around for survival at the cost of serving needs and genuine sustainability. Innovation would atrophy.

Sensible individual actions can be collectively foolish. Such would be the case here. Reducing our commitment and ability to face these major social challenges today will only make them more expensive to cope with tomorrow – and leave us with a weaker collective capacity to respond effectively to them.

### **However, the recession also demands radical new approaches**

In one sense, the deeper the 'crisis', the more we are forced to recognise the need for radical approaches. Reducing budgets for public services by a few per cent here or there won't restore public finances to a more stable condition, let alone reinvent these services in ways that will enable them to respond to the challenges we face. Real efficiency – plus real responsiveness to people's needs – requires a greater boldness in rethinking public services.

Equally, tinkering around the edges of technologies won't radically reduce their impact on the environment or reverse climate change. True environmental sustainability demands the application of a greater effort than has been achieved so far.

Similarly, we can't afford an ageing society, but we can and must afford a society that takes a new approach to ageing – a society that develops new services and programmes that help older people remain active and make a continued contribution to society in return. Are

we ready to acknowledge that the apparent epidemic we are experiencing in mental illness won't be confronted by a few more (or fewer) services here or there, but by confronting the causes of these conditions and – it seems likely – our widely-held attitudes to mental health as well?

### **Crisis has often spurred radical new approaches in the past**

We might associate 'innovation' with the boom times and – frankly – a fair amount of frivolity. Slightly thinner iPods are nice, but what we really need now is a significantly less obese society.

Many significant innovations, whether ultimately positive or not, have of course been developed in response to major economic and social challenges such as war and international tensions, famine and disease. Such innovations range from new technologies (the jet engine, radar, nuclear technologies, satellites, the green revolution in agriculture, the internet, DNA profiling, white LEDs), to new organisational forms and services (the cooperative movement, the welfare state, distance learning, microcredit and microfinance).

Adverse economic and social conditions can also spur a renewal in older forms of social organisation and action. For example, some of the current wave of social innovation and entrepreneurship can be traced back to the recession of the early-mid 1980s, when third sector groups were formed to work in distressed communities and with distressed groups such as the homeless.<sup>68</sup> Interestingly, nearly half of all local authorities agree that the current recession is also creating opportunities for new ways of working, such as improving inter-agency co-operation to tackle local problems, and given falling land values, buying land to provide affordable housing.<sup>69</sup>

Without being blasé about the challenges we face now, pressure on resources can act as more of a spur to innovation than plenty. The critical issue is to have the right kind of resources and support for new approaches, and not to prop up old and unsuccessful models.

### **We need radical innovation in public services and beyond**

Incremental improvement alone won't enable us to respond to major economic and social challenges. 'Radical innovation' in our public services – including in who organises and provides them – will be needed to deliver significantly better outcomes for significantly lower costs.<sup>70</sup> Radical innovation in policy, regulation and private practices is the only way we will meet the crisis of climate change. Radical innovation in our attitudes to ageing, health and wellbeing will be required to inspire and develop the new services, programmes and behaviours we need.

Government has a vital co-coordinating role to play given the scale and scope of the changes we need. But it will also call on the effort, investment and ingenuity of the private and third sectors, and society more generally. And it will rely on stronger relationships between the state, the market and civil society, as established by such factors as investment and support, regulation, knowledge and expertise, leadership and culture. This means creating the optimum conditions for this innovation, not just creating the innovations themselves.

In order to understand how to create these conditions, and so provide public services with the greatest chance of harnessing innovation in response to the major challenges we face, it is necessary to understand the broader field of 'social innovation' – what it is, where it comes from, who does it – but also some of the difficulties faced by innovators in the public, private and third sectors.

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# THE RISE OF PUBLIC AND SOCIAL INNOVATION

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Radical new approaches require radical new actors. We need to combine the ingenuity and initiative of a diverse group of innovators – from the public sector, private companies and third sector, alongside users and communities – to find new solutions to pressing economic and social problems.

As already noted, innovation in public services can be conducted by public, private or third sector actors.

‘Social innovation’ is broader than innovation in public services, but as will be examined in this section, there is an important relationship between the two that could be exploited more effectively in order to respond to the major economic and social challenges we face.

### **Social innovation is innovation for the social and public good**

‘Social innovation’ means different things to different people:

- To some, social innovation means the innovations developed and delivered by the third sector, such as charities, voluntary organisations and social enterprises, that is, innovation that is not motivated by private profit.<sup>71</sup>
- To others, social innovation means any innovation that contributes to alleviating or solving a social problem, such as poverty or pollution, whether by the public, private or third sectors and irrespective of its motivation in statutory duty, profit or passion. In some cases, this even extends to include corporate social responsibility.<sup>72</sup>
- To still others, social innovation represents a ‘new social economy’ that is more about new social movements and social relationships that cut across increasingly blurred boundaries between the state, the market, the household and grant-based organisations.<sup>73</sup>

From the perspective of the challenges we now face, it is most helpful to consider ‘social innovation’ as reaching beyond the third sector (important though it has been for the development of many new approaches) – but not as far as corporate social responsibility (important though this may be for a more sustainable economy). This allows for social innovation to be a broad but not all-encompassing term (and so effectively meaningless).

Social innovation is innovation that is explicitly for the social and public good. It is innovation inspired by the desire to meet social needs which can be neglected by traditional forms of private market provision and which have often been poorly served or unresolved by services organised by the state.

Social innovation can take place inside or outside of public services. It can be developed by the public, private or third sectors, or users and communities – but equally, some innovation developed by these sectors does not qualify as social innovation because it does not directly address major social challenges.

These overlapping areas of innovation are illustrated in Figure 2 (note that this illustration is purely for conceptual purposes; the area of any particular sphere does not represent its importance or the extent of innovative activity present).

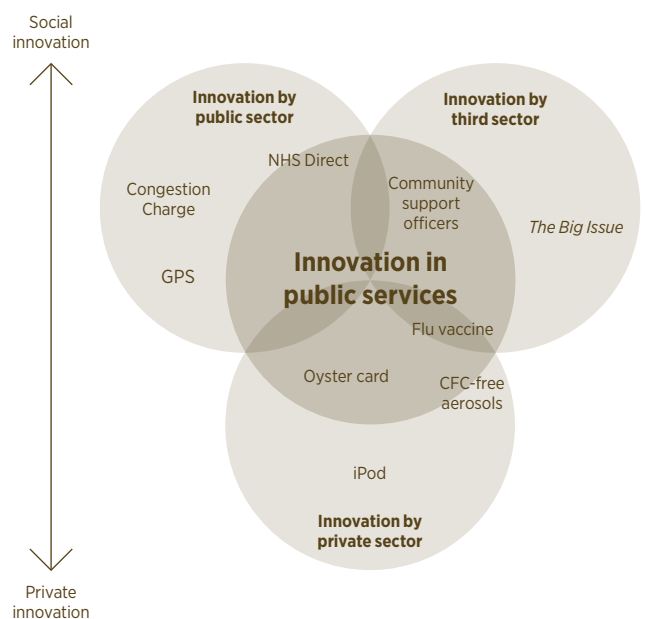
So, to illustrate this ‘map’:

- NHS Direct was developed by the public sector for use in public services.
- GPS was developed by the public sector but not for use in public services.
- The Oyster card was developed by the private sector for use in public services.
- *The Big Issue* was developed by the third sector but not for use in public services.
- Community support officers were developed by the third sector for use in public services.
- The iPod was developed by the private sector but not for use in public services.

And in terms of innovations which address the most critical social challenges, such as climate change and public health issues:

- The Congestion Charge was developed by the public sector but not for use in public services.
- CFC-free aerosols were developed by the private sector but not for use in public services.
- The flu vaccine was developed by the public sector for use in public services.

**Figure 2: Dimensions of innovation**



The growing interest in social innovation hasn't happened by accident. It has come as a result of a gradual but radical shift in how we understand 'innovation', the limits of the state and of the market, and as a result of what some commentators regard as a new social movement. Many of those involved in this 'movement' may not have seen what they have been doing for many years as 'innovation', but rather just as attempts to resolve pressing social problems by 'doing things differently'. But it is possible to suggest that we have entered a new era in which social innovation could be harnessed as a potentially powerful force for positive change and a new way of responding to the challenges confronting us.

### **Interest in social innovation has been growing over the last two decades**

This is for four main reasons.

#### **Our understanding of innovation has broadened**

Firstly, innovation is increasingly being understood in a broader way, beyond the invention of new technologies based on the latest scientific understanding. In effect, we are in a period of major transformation in what we mean by 'innovation'.

Traditionally, which is to say for the past 50 years, 'innovation' has often been synonymous with scientific and technological invention born of new research-driven knowledge ('traditional innovation'). It was what high-technology businesses did in their research and development (R&D) labs, rarely something done in the public or third sectors.

However, it has been increasingly obvious that many forms of innovation are neglected by this traditional linear or 'science-push' model, for example new services, organisational forms and business models. These are examples of what might be called 'hidden innovation' – hidden because these forms of innovation have gone largely unmeasured by official statistics and indicators of innovation, and because their potential has often been neglected.<sup>74</sup> This hidden innovation is often as prevalent and important in research-intensive sectors as it is in service sectors – and indeed in public services.<sup>75</sup>

Today, we are increasingly understanding innovation in a very much more open way than in the past, allowing for a much broader application of the term to different fields. For example, once we began to understand that innovation could be as much about new services or organisational forms as new technologies, then this made it much easier to apply to the public and third sectors.

Recently, policy has begun to recognise this hidden innovation. Most importantly, *Innovation Nation*, the White Paper published in March 2008 by the Department for Innovation, Universities and Skills (DIUS), gives a prominent place to hidden innovation and innovation in service sectors of the economy and in public services.<sup>76</sup>

However, the White Paper had less to say about what policy mechanisms are required to stimulate and support this hidden innovation.

#### **A renewed 'movement' for social innovation has emerged**

Secondly, a new breed of thinkers and entrepreneurs has been increasingly dissatisfied with the traditional approaches to public needs as developed by the state, the private sector and charities.

In the UK, organisations such as the Young Foundation, the Social Enterprise Coalition, Futurebuilders England, and UnLtd (the Foundation for Social Entrepreneurs) develop social enterprises and build understanding of how effective social innovation can be stimulated and scaled. Government has estimated that there are more than 55,000 social enterprises alone in the UK, contributing £8.4 billion in GDP to the economy.<sup>77</sup>

These thinkers and entrepreneurs have also pointed to the UK's rich tradition of social innovation, including in public services and the public sector, and in doing so have helped to drive a renewed interest in such innovation.

Local government has been responsible for many innovations – most notably in its development of bold new approaches to public health, utilities and welfare (many of which were subsequently adopted by central government).<sup>78</sup> This tradition of imaginative reform continues today across many public services.<sup>79</sup> Some of the more prominent recent examples of innovation in public services include NHS Direct and Learndirect, online tax transactions, Sure Start and Connexions, the London congestion charge and Children's Commissioners.<sup>80</sup>

As well as local government, such innovations often have their roots in the third sector; for example, NHS Direct was preceded by Healthline, and the Open University by the National Extension College (in both cases established by Michael Young, the famous social entrepreneur). Similarly, neighbourhood warden schemes eventually persuaded the police to create a new category of Community Support Officer. Probation services and child care also have their roots in charities and voluntary groups.

The long emergence of social innovation to its current prominence represents a growing recognition of the inherent limits of the state, the market and of voluntarism as they are traditionally conceived. For the new social entrepreneurs, a common criticism (or rather critique) of existing institutions has been the way in which they approach and understand citizens, customers and clients: often with self-interested assumptions and preconceived 'solutions' rather than a deeper understanding of their needs and assets. And, clearly, many significant social problems are still with us – from poverty to poor health and education.

For some commentators, these social innovators represent just one aspect of the emergence (or more properly, the recognition) of a 'new social economy', which has profound implications for the future of public services as well as for the daily life of citizens.<sup>81</sup> This represents a new economy because it melds features which are very different from economies based on the production and consumption of commodities, such as: the intensive use of distributed networks to sustain and manage relationships; blurred boundaries between production and consumption; an emphasis on repeated interactions, care and maintenance rather than one-off consumption; and a strong role for values and missions.

This new social economy can be found in parts of the public sector, the non-profit world as well as commercial markets, and in 'the household' – the private sphere that has given rise to the new social movements of the 1970s such as feminism, the black movement, gay rights and equality for those with disabilities. But this new economy can be found most of all in the areas where the sectors overlap – often through the power of community action. It is helping to address some of the most intractable problems facing society, including climate change, ageing, and inequality.<sup>82</sup> (However, as discussed below, this emerging economy lacks adequate capital, methods, skills and support, and could easily be thrown into reverse by the current context).

#### The limits of the prevailing reform agenda in public services have increasingly been revealed

Thirdly, the limits of the 'new public management' reform agenda for public services and the public sector are increasingly apparent in the face of major economic and social challenges.

New public management emphasised that a greater market-orientation in the public sector will lead to increased efficiency (in contrast to older bureaucratic approaches based on hierarchy and rule-adherence). It has dominated public sector reform since the 1980s, in the UK and in many countries around the world. Like any term, 'new public management' has been interpreted in different ways by different commentators, and has been attached to a range of policies and approaches – privatisation and contracting-out, creating competition between different public agencies and private firms, continuous increases in efficiency and quality, and the importance of measuring performance (including through audits and inspection). Fundamentally, it can be seen as resting on the belief that the key to reinventing government is changing the incentives that drive public institutions by restructuring the 'markets' that operate in the public sector and public services.

New public management has gained many supporters and detractors, who have argued over the evidence of greater efficiency or quality as a result of such practices, the institutional complexity that they have sometimes generated, and the effects on the motivation of public sector workers.

More importantly for our purposes, however, such approaches seem unsuited to the major challenges we face now. Despite the often-contentious changes associated with new public management in the public sector, these practices can be regarded with hindsight as most associated with incremental improvement in existing services rather than with radical innovation, for example in developing whole new types of services or in establishing new relationships with the users of services.

For some commentators, more recent theories of reform in government and public services offer a broader basis for reform compared to the relatively narrow new public management agenda. For example, proponents of 'public value' point to its focus on outcomes from services and programmes, and its recognition of the importance of trust and legitimacy between government and citizens.<sup>83</sup> ('Public value', put simply, is what the public values; it is the role of public managers to help determine through democratic processes and public engagement what social outcomes are desirable, thereby in theory redressing the 'democratic deficit' between public services and citizens).<sup>84</sup>

Such approaches are potentially better positioned to recognise that public service managers, professionals and front-line workers operate within complex, changing systems with characteristics which are very different from a simplified notion of markets, with many more 'stakeholders' beyond their immediate 'customers', and often with regard to broader economic and social conditions and objectives.<sup>85</sup>

#### Consensus is growing that we need to respond urgently to major social challenges

Fourthly, there is a collective sense that significant and widespread innovation will be crucial to responding effectively to major social challenges such as climate change and an ageing society.

Traditional innovation is insufficient for the challenges we face. New-to-the-world technologies will help, of course, but on their own they will not resolve climate change, an ageing society or reinvent public services. Such challenges will defy technological 'silver bullets'; they have multiple, sometimes conflicting dimensions, in policy, markets, public services, and public behaviours. The intelligent application of technology, including already-existing technology, will often be more important than the invention of new technology.

These four factors have converged to make social innovation a critical element in the battle to address both short and long-term economic and social challenges. It has helped to renew an interest in innovation in public services, but also appears to have the potential to draw on the imagination and expertise of a broader set of innovators and entrepreneurs from outside the public sector.

### **As a result, innovation has been moving into the policy mainstream**

Over the past few years there have been a range of government initiatives and funds to support innovation.

#### **Examples of support for innovation in UK central government**

- The 2008 Cabinet Office paper *Excellence and Fairness: Achieving World Class Public Services* highlighted innovation as vital for developing more customer-focused, efficient and sustainable public services,<sup>86</sup> and innovation continues to be a focus of the Transformational Government agenda.<sup>87</sup>
- The Department of Health sponsors the NHS Institute for Innovation and Improvement, a £70 million per year body charged with promoting and embedding innovation and improvement within the NHS, which includes a National Innovation Centre and ‘innovation hubs’ in nine English regions (supported by £230 million over the next five years by the Department of Health, the Department for Innovation, University and Skills, and the Office of Science and Technology).
- The Department for Children, Schools and Families invested £9 million over five years in a series of ‘next practice’ programmes and ‘communities of practice’ supported by The Innovation Unit (then part of DCSF, now an independent, not-for-profit organisation).
- The Department of Transport created a Transport Innovation Fund to allocate resources to tackling congestion and improving productivity (in 2009-2010 the available budget is set to rise to £600 million, and by 2014 to £2.55 billion).<sup>88</sup>
- The Department for Innovation, Universities and Skills is convening a network of Whitehall innovators to demonstrate a commitment at a senior level. DIUS is also sponsoring New Partnerships for Innovation that will bring together venture capital, universities, business and regional government to align efforts and develop innovative solutions to local and regional challenges.
- The Sunningdale Institute (part of the National School of Government) is working with partners to create a Whitehall Innovation Hub, a new partnership of organisations to capture and disseminate learning about public sector innovation, for example, establishing learning across government departments and public services.

In addition, there has been a focus on using public procurement to stimulate and support innovation more effectively. Government procurement accounts for over £120 billion annually, in theory creating a huge potential market for innovative solutions. Further, again in theory, outsourcing could drive innovation in public services; the ‘public services industry’ in the UK has grown by 130 per cent since 1995, employing 1.24 million people with an annual turnover of £79 billion (5.7 per cent of GDP).<sup>89</sup> This ‘industry’ now delivers around a third of all public services. But the impact of both of these mechanisms on innovation depends on how they are used, and they have often been said to inhibit and marginalise innovation in practice (for example, procurement contracts being given disproportionately to large established companies, and contracting-out focusing on lowest-cost as opposed to value for money or outcomes criteria).

#### **However, innovation systems in public services still require much further development, especially in relation to the major challenges we face**

This is for four related reasons.

Firstly, there are insufficient resources – or perhaps more accurately, insufficiently distributed resources. Large-scale projects led by central government departments may receive many millions of pounds in funding, but resources are far more limited for most organisations involved in delivering public services. Typically, what innovation there has been has often been incremental and off the back of discretionary money.

Comparing private sector R&D intensity rates (R&D spend as a percentage of total sales) to public sector ‘innovation intensity rates’ (earmarked innovation or research budgets as a percentage of overall budgets) creates some interesting contrasts.

### **'Innovation intensity' in UK central government departments**

- The Department for Communities and Local Government earmarks 0.21 per cent of its total £34.3 billion budget for innovation and research. This is comprised of the Improvement and Development Agency's annual budget of £48.9 million and the department's annual budget for research of £22.9 million (part of the department's Evidence and Innovation strategy).<sup>90</sup>
- The NHS dedicates 0.9 per cent of its budget to innovation, in the form of R&D funds, the budget apportioned to the NHS Institute for Innovation and Improvement and the regional innovation hubs.<sup>91</sup>
- The Department of Transport contributes 1.99 per cent of its £17.6 billion budget to innovation, in the form of the £0.29 billion Transport Innovation Fund<sup>92</sup> and £0.06 billion dedicated to R&D programmes (although as noted above, the Transport Innovation Fund is set to increase considerably over the next five years).
- Aggregating the budgets for R&D and innovation programmes gives the Department for Children, Schools and Families (DCSF) an innovation intensity rate of 0.17 per cent. Of its total budget of £50.2 billion, £62 million is spent on R&D and £23 million on A 'Parent Know How' Innovation Fund,<sup>93</sup> which encourages providers of parenting information and support to focus on new ways of engaging parents.
- Figures from the Home Office Science and Innovation Strategy report 2005-2008<sup>94</sup> calculate the total budget for research and innovation programmes across Home Office services as £70 million. This figure is spent on research and innovation in five core areas of interest: immigration and nationality (6 per cent of the total); criminal justice system reform (7 per cent); offender management (13 per cent); communities (6 per cent); and crime reduction and community safety (68 per cent). Out of a total Home Office budget of £9.6 billion, this gives an innovation intensity rate of 0.73 per cent.
- With no obvious budgets allocated to programmes for innovation within the Department of Work and Pensions, only 0.14 per cent of the £12.4 billion budget (excluding pension payment transfers) is spent on research and development.

Such calculations inevitably overlook some resources and initiatives that could reasonably be regarded as supporting innovation, but they do still provide a provocative contrast with the commercial companies; the average private sector R&D intensity rate (averaged across all manufacturing sectors) is around 4 per cent, and up to 15 per cent in sectors such as pharmaceuticals.<sup>95</sup>

But it's not just a matter of funding, of course; it's also about what the money is spent on and how the innovation is conducted.

Secondly, the forms of innovation that tend to dominate public services appear increasingly problematic, especially in the face of major challenges. In terms of innovation led by central government, there is a tendency towards large-scale, technology-led projects. According to one account, admittedly with a bias towards this type of innovation, the average innovation in central government takes 24 months to deliver and costs £900,000, but a minority of projects are much bigger and take much longer.<sup>96</sup> Such innovations are dominated by senior management; contributions from lower-level staff tend to be marginalised<sup>97</sup> (think the National Programme for IT in the NHS).

In terms of policy innovation more broadly, there is a similar top-down tendency; some public sector reform has been driven through too fast, in effect experimenting on the whole population rather than on a small-scale (as is the norm in private sector medical or technology innovation).<sup>98</sup> This reflects that it is often highly-centralised, with small upfront 'R&D' in the form of policy and research work, followed by (sometimes) short-term pilots and large-scale roll-outs (think the poll tax). Clearly, public services represent a very different context to much of the private sector, but these comparisons can be useful in highlighting some aspects of change in the public sector in particular.

Thirdly, these approaches to innovation are reinforced by institutional and cultural barriers that inhibit other forms and sources of innovation. Public services are organised into silos that often do not cooperate. Public servants are often hidebound by regulations that inhibit local initiative, discretion and risk-taking – or at least they feel that they are (a legacy of previous centrally-directed reform). There are few explicit rewards for acting entrepreneurially and many obvious downsides to failed experiments. And users, clients and citizens are rarely invited to engage in the innovation process.

In particular, the current mode tends to crowd out smaller-scale and especially local innovation. It disaffects and demotivates many public services employees. It reinforces the suspicion that innovation is something that is done to them, not by them. It produces innovations that often fail to link effectively with local conditions, let alone local innovations. And, most obviously, it tends to cost a huge amount of (public) money that could have been spent in a very different way, quite possibly to better effect.

This also helps to explain why private and third sector providers – who can generate new approaches to service provision – have been channeled to focus largely on cost-cutting, value for money and improving the efficiency of existing services.

Fourthly, alongside a lack of resources, third sector organisations often lack the scale and expertise to innovate more effectively. In particular, there are systematic weaknesses that inhibit the diffusion, replication or scaling-up of innovations developed by such organisations as voluntary groups and social enterprises, including: weak incentives for public agencies to copy or fund more effective alternative models; the absence of intermediary bodies and networks that specialise in connecting supply and demand; and a lack of access to capital to fund growth in social organisations.<sup>99</sup>

The result is that we lack functioning, efficient and disciplined systems of innovation in public services; the innovation systems that do exist tend to be rather fragmented and lack rigorous methods.

What this brief survey suggests is that we need to develop a much stronger set of processes and methods, supported by the broader understanding of social innovation that would encourage policymakers to consider the role that a wider set of actors could play in innovation in public services.

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# THE INNOVATION WE NEED

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We need a new way of innovating in public services – a rigorous experimentation, focused on major challenges, and which encourages and embraces local solutions.



### **A new approach to innovation in public services**

We should ensure that innovation in public services is central to our response to the recession and beyond. But this should not mean merely continuing the important but incremental progress that has been made so far. We need radical innovations to improve our public services. But more fundamentally, we need a radical new approach to innovating in our public services. To address the major social and economic challenges in a period of massive financial constraint means bringing into being and diffusing necessary radical, compelling innovations in public services and beyond, and that requires a disciplined and focused approach. This has a number of elements.

Firstly, it means developing a much stronger capacity for innovation, not just many more specific innovations. Finding, developing, testing and implementing new approaches in a serious and systematic manner will have to become a central concern and capability of public services and beyond. After all, some of the challenges we face are unlikely ever to be resolved completely – but they can be managed successfully. We will always face new problems and new circumstances, and so we will always need a capacity for introducing imaginative change.

We also need sufficient local autonomy to innovate in public services, to produce the necessary diversity from which we can select the best innovations. Overall, the balance needs to shift towards local experimentation – only this will produce sufficient diversity to provide the radical new approaches we need. Paradoxically, the only way we will be able to respond effectively to the large-scale social challenges facing us is in part through a much greater number of initially small local experiments.

This shift is also crucial to putting users, consumers and citizens at the heart of innovation in public services as never before, as a way of driving change and, in the future, as partners in organising the delivery of services.

Lastly, many of the most radical innovations in public services are likely to be developed outside of existing services, rather than within them. For this reason, we also need a capacity outside of existing public service organisations, to produce the more radical innovations that we will need to respond to major social challenges – but within a larger system of increasing expertise and support for innovation in public services.

The recession makes all this more important and urgent, rather than something which can be deferred until the ‘crisis’ passes. Without a new approach to improving our public services, they will be over-stretched by the short-term demands of the recession and overwhelmed by the long-term challenges of the future.

### **The conditions for innovation in public services**

This will depend on the best possible ‘enabling conditions’ for innovation being in place.

Over the last decade, governments and departments, agencies and organisations, have learnt more about the conditions necessary to stimulate, foster, encourage and diffuse radical and compelling innovation in public services. And the characteristics of high-performing, innovative sectors have become clearer. These are described in summary below, under four themes: culture and leadership; support and investment; rewards and incentives; and shape and openness.

#### **Culture and leadership**

- Organisations that combine a strong culture of experimentation and innovation with consistent, high quality in established activities.
- Innovation is valued and valorised, rewarded and celebrated.
- Innovation is embedded in the values and purposes of organisations.
- There is a coherent narrative of how innovators, innovation and the adoption and diffusion of successful innovation is encouraged and supported.
- Leaders set clear and ambitious goals and desired outcomes, but do not prescribe processes for how to achieve them.
- Managed and informed risk-taking is encouraged; and it is recognised that the path to successful innovation is strewn with unsuccessful attempts.
- An external orientation, learning from others (departments, organisations, sectors, and countries) is fostered: networking within and beyond organisations.
- The front-line, users and citizens are valued as sources of innovation, and engaged in the innovation process.
- Space and time for innovation is created, and innovations are championed and shielded in their fledgling periods.

### Support and investment

- There are sources of finance and capital – investment funds and venture capital – available to create possibilities, incubate promising ideas and support innovative start-ups.
- These funds have sufficient autonomy and appropriate expertise to spread and pool risk, balancing investment in potentially high-risk, high-reward innovations and safer but less dramatic innovations.
- The majority of this financing is focused on the strategic priorities, the major challenges for the sector or services.
- Supporting innovation requires not just finance, but also wrapping around innovators the necessary support, skills and expertise for disciplined innovation, including: ethnographic, design and other approaches for issue analysis and ideation; modelling, simulation, rapid prototyping and other techniques for carefully bounding risk; change management and leadership of change for organisations implementing or adopting innovation; business case preparation, business planning and marketing.
- There is an adequate range of innovation ‘intermediaries’ or ‘brokers’ to provide the necessary support, skills and expertise.
- Organised R&D is focused on the long-term challenges facing the sector – not just the improvement of existing services and processes – and the findings are disseminated widely.

### Rewards and incentives

- Organisations which innovate successfully, or adopt successful innovations, are rewarded financially, reputationally and in terms of increased ‘market’ share. The combination of financial rewards for successful innovation and appropriate funding available to support innovation create longer-term planning and the ability to capture returns on investment.
- Status and (development and promotion) opportunities are accorded to teams and individuals who innovate successfully or adopt successful innovations.
- Commissioning and procurement are focused on outcomes and quality rather than inputs and processes, thus creating the space for innovative organisations and approaches.
- Appropriately detailed and timely outcome and performance information is available to providers and commissioners, policymakers and the public. This should provide the basis for peer-to-peer learning, and for users and citizens to evaluate different services.
- Regulatory regimes and inspection agencies have regard to organisations’ success in innovation and their capability for innovation.

### Shape and openness

- High-performing, innovative sectors have common ‘shape’ characteristics: a small number of large, dominant players; a wide and dynamic periphery of niche providers, specialist suppliers and innovative start-ups; much innovation comes from the periphery, but the large players – by virtue of their scale and scope and their already established platforms – take these innovations to scale (often through merger and acquisition). In contrast, disaggregated sectors – like much of public services – have low rates of diffusion.
- Openness: successful, innovative start-ups and new innovative practices are able to displace older, less effective services, hence decommissioning and disinvestment are crucial.
- There is considerable mobility and strong networking, and common labour and supplier pools, between organisations (a major reason why innovative organisations in a sector tend to cluster).

What is clear from the above is that the conditions which enable public services to be innovative are not just activities in direct support of innovation – funds, prizes, intermediaries and so on – but also funding and pricing regimes, regulation and inspection frameworks, competition and collaboration policy, the handling of ‘failure’ and under-performance and, of course, leadership and culture.

Further, it is clear that the problem of weak diffusion of innovations in public services is not just caused by a lack of information or awareness. While numerous examples of effective, innovative practice can be found across public services, they all too often stay ‘locked on location’, not spreading to other departments or organisations. The most common response has been to ‘turn up the volume’: clearer messages; flashier websites; glossier pamphlets. But diffusion is as much, if not more, about ‘pull’ factors. These are the factors which predispose organisations, teams and individuals to want to search out and adopt innovations – rewards and incentives, shape and openness – as about how hard we ‘push’ innovation.

## Recommendations

### 1. Promote and support innovation in central government

- Major government departments, including in UK central government and devolved governments, should each designate at least 1 per cent of their budgets to a departmental fund for innovation.

This should come from existing budgets, and focus on where innovation can be directed towards significantly improved outcomes at significantly lower costs. Progress against this commitment should be reported on in the DIUS Annual Innovation Report.

Total departmental spending across UK central government bodies (excluding defence, pensions and benefits) is £267 billion.<sup>100</sup> Dedicating only 1 per cent of these budgets to innovation would therefore provide a total resource for innovation across government of £2.7 billion.

- Government should create cross-departmental ‘challenge funds’.

There are inherent and understandable difficulties in getting government departments to collaborate more effectively. One way of supporting this could be through ‘challenge funds’ to encourage and support innovative cross-disciplinary solutions, in areas such as an ageing society, wellbeing, services for young people, and offending. These funds should be sponsored from the top of each department, but also involve participants from outside of government – including users – to review proposals for funding and challenge existing barriers to innovation (whether in policy, funding or departmental structures and culture).

- Accelerate support for innovation through procurement.

It is widely agreed that government could use its huge purchasing power to support innovation more effectively. The proposed reform of the Small Business Research Initiative (SBRI) is particularly welcome; however, the SBRI addresses at best only 2.5 per cent of government research and development spending. In addition to the 1 per cent budget commitment, better training for government buyers, and a more flexible approach to managing financial risk would allow procurement to use smaller, less established but potentially more innovative organisations (including social enterprises) to become providers.

- Move to zero-based budgeting for a range of public sector bodies, and 3-year sunset clauses on new bodies and initiatives.

Innovation is not just about trying new things; it’s also about stopping things that aren’t working, or which represent barriers to innovation, more quickly and decisively. We shouldn’t over-advantage the existing against the new and potentially more effective or more efficient. New budgeting processes are required to ensure that a strong case is made for each agency and service.

### 2. Create stronger incentives for the development and adoption of local solutions

New Multi-Area Agreements provide a framework for local authorities to come together to focus on their economic challenges and opportunities at a sub-regional level – issues such as transport, housing and skills that cut across administrative boundaries. Further, in 2008 the Government allocated £185 million to fund Regional Improvement and Efficiency Partnerships, to support local authorities to make savings through strategic agreements with other authorities and public services (for example, through joint procurement of services). But more needs to be done to ensure vibrant and viable innovation at a local level.

- Downgrade large-scale IT projects.

We need *less* support for some forms of innovation which often dominate current central government policy. There is a tendency in government for ‘big mode’ innovation – costly and extremely complicated IT projects, driven from the centre without sufficient support from and awareness of the needs of the public sector employees who actually do the job and the users who depend on the services. Such forms of innovation, which represent a legacy of the traditional technology-led linear model of innovation and tend to be dominated by 20th century suppliers and solutions rather than 21st century innovators and tools, should be downgraded and re-shaped wherever possible.

- Radically reduce the number of targets for public services.

Targets can be the enemy of innovation, especially if focused on inputs, processes and activities (they can also create perverse incentives). Some progress has already been made to reduce the number of indicators – and from these the targets – to which the public sector is subject.<sup>101</sup> More needs to be done, to reach a small set of core targets focused on outcomes that central government policymakers actually need for reasons of prioritisation and political accountability.

- Streamline audit and inspection regimes for public services.

With fewer indicators and targets should come a slimmed-down audit and inspection apparatus for public services. Accountability is important, but the ways in which it is achieved have sometimes inadvertently reinforced a culture where experimentation is career-threatening, if there is scope for it at all. Although external pressures, including inspections, can play an important role in triggering change, performance frameworks need to evolve to assess and reward innovation – and the demand for innovation from elsewhere – rather than focusing exclusively on current performance. Streamlining these bodies would also save significant amounts of public money, of course.<sup>102</sup> Progress in streamlining and producing cost savings has been made by inspectorates such as Ofsted and the Healthcare Commission, but more remains to be done across a broader range of institutions.

- Give every public service organisation the ‘power to innovate’.

Central government granting public organisations the right to innovate sends exactly the wrong message. The process should be reversed: all public organisations should have the right to innovate unless it is explicitly removed from them (for reasons of unusual political accountability or poor performance).

- Move funding to providers to commission support from organisations that support local innovation.

Some of the money saved from cutting back on large-scale central projects and the audit and inspection regime should be distributed to public service providers so that they can use it to commission organisations that support innovation at the local level. A mechanism for this might be in the form of ‘innovation credits’ given to providers. Some of these organisations are focused on local government (such as the IDeA, the Local Government Association and Local Government Leadership Centre), some on parts of the public sector (the NHS Institute), while others are focused on the third sector (Innovation Exchange). Currently, many of these organisations have insufficient resources to support localities to innovate, especially in relation to the scale of the economic and social challenges we face.

### 3. Open up innovation in public services to a wider set of actors

Our response needs to be much broader than central and local government, and public sector agencies. It needs to engage a much wider range of organisations, innovators, entrepreneurs and users in a more vibrant innovation ‘ecosystem’ – from private providers, to the third sector and beyond. Much of the innovation we need will come from actors such as social enterprises, which are often quicker to respond to emerging needs, resources and solutions than the public sector. And over time, we must strive to involve citizens in both the design and the delivery of public services. Public service programmes will be far more effective if they work in partnership with civil society, supporting a process in which communities explore ways forward out of the downturn.

- Require public sector commissioners to develop new markets for public service delivery, particularly for a wider range of providers.

Developing stronger, more diverse markets for local services would encourage a wider range of actors to compete for contracts. These markets must be based on a better understanding of user needs on the part of commissioners. In some cases, this will mean breaking contracts down into smaller lots (many social enterprises offer innovative solutions but cannot immediately take on whole contracts); in others, it will mean larger contracts that cross several traditional service ‘silos’ (such as mental health care, housing and employment services). In both cases, commissioning for innovation is crucial; a stronger articulation of the outcomes being sought should encourage organisations and people to come together in new ways to deliver these outcomes.

Local government should also work to create markets in their area for delivering public services; this will mean that local leaders will have to develop expertise in how to support these markets.

More generally, the UK needs a richer set of funding sources, to cover the diversity of types of need and risk involved in innovation (including grants, loans, equity and guarantees).

- Create and support local Social Innovation Zones.

Government should explicitly license more radical innovation as communities seek to respond to the recession: Social Innovation Zones. These zones would be supported by devolved budgets, so that communities can devise integrated and creative responses to the downturn, bringing together employment, training, education, business creation, social enterprise, culture and regeneration.

Further, it is crucial that the new wave of innovation in public services engages local communities – the users, consumers and citizens that will be so crucial to radical innovation in the future. This would encourage the diversity in innovation that we need, and better root such innovations in particular local conditions and challenges. An additional advantage of this local emphasis is that it allows for a much stronger link to behaviour change. Tackling many of the challenges we face will require public services to work to change with people to change behaviours (health and climate change being only the most obvious examples). Such community engagement is especially important in a recession, where social capital can shrink alarmingly and which can further exacerbate some existing challenges such as crime and social cohesion.

#### 4. Strengthen intermediary organisations

With a greater emphasis on local innovation must come a greater capacity to learn from rigorous experimentation at a local level and to disseminate the results – learning, practices, innovations – more widely, more quickly. For this, we need a stronger range of intermediaries to broker links between different providers and to connect creative ideas to practitioners on the ground.

Such intermediary organisations can play a central role, by promoting collaboration across places, people and sectors, providing access to networks of capital and spreading best practice across the system. They can help innovators to demonstrate the commercial value of public services innovation, helping to leverage in private sector money which otherwise would not have believed that there was an opportunity. While this has successfully occurred in science and technology innovation for many years, there is only an emerging set of such actors for public services innovation. This has also meant a lack of systemic learning.

The current methods in use – such as formal pilots, pathfinders and collaboratives, as well as the many methods drawn from design, technology, communities of practice, social entrepreneurship and venturing – need to be developed further and fitted better to the needs of radical innovation in public services by public, private and third sector organisations. In short, a field which remains fairly ad hoc and short on evidence needs to mature quickly to help localities innovate effectively in response to challenges such as ageing, climate change, poverty and competitiveness.

The Lab, launched by NESTA, is one example of a new intervention that can perform this kind of role, alongside existing statutory agencies such as the IDeA and the Design Council, and independent bodies such as The Innovation Unit, The Young Foundation, UnLtd and the Innovation Exchange.

#### The Lab: innovating public services

Our society is facing urgent and complex challenges. Economic turbulence, environmental threats and a rapidly ageing population are triggering profound changes to the way we live and work. But our public services – from health to transport and education – are not geared to cope with the scale of these challenges, or the pace of change.

Fresh thinking is urgently needed. We can't continue to tinker at the edges, particularly in the face of an economic downturn. Without bold new approaches, our public services will be over-stretched by the short-term demands of the recession and overwhelmed by the long-term challenges of the future. What alternatives do we have to radical innovation?

So NESTA has created the Lab to meet this need for bold new ideas that work. By bringing together experience and ingenuity from across the public, private and third sectors, and drawing on the insights of citizens and consumers, the Lab plays a vital role in making public services fit for the 21st century.

The Lab provides the freedom, flexible capital and expertise to undertake radical experiments. It tests out new ways of finding and spreading the best ideas – this might be by running a challenge prize, building a social ventures incubator, or creating powerful new teams of users, front-line staff and decision-makers.

The Lab is not a physical space or an institution – it’s a series of practical projects, informed by research and delivered in partnership with those that run and use our public services. It shares lessons about what works – and what doesn’t – and creates opportunities for people to solve problems together.

The Lab’s success will be measured in two ways. First, has it contributed to the development of better services – and in these challenging economic times, has it found ways of delivering better for less? Second, have its methods and approaches been adopted by others to improve people’s lives.

Working with stakeholders across the UK, the Lab is structured around three main programmes:

- Challenge Lab: Demonstrating ways of innovating that change the way public services are delivered in response to the most critical social challenges. In 2009, we are looking at innovations in response to climate change and an ageing society, and to promote new models of well-being.
- Methods Lab: Exploring how to innovate in public services, trialling new ways of stimulating and spreading new ideas and understanding the methods and approaches that work best.
- Learning Lab: Building an inspiring programme of events, workshops and materials, helping to connect and energise social and public innovators across the UK.

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100. This figure excludes transfers made for either pensions or benefits, and does not reflect the creation of the Department for Energy and Climate Change in 2008.
101. For example, the Scottish Government has begun to take this approach, moving towards objective-based measurement of progress rather than targets.
102. The overall cost of monitoring local government has previously been estimated at around £2 billion a year; see National Audit Office (2006), National Audit Office Response to Sir Michael Lyon’s Inquiry into Local Government London: National Audit Office. A Department for Communities and Local Government report found that the average cost to councils of central government performance reporting requirements was £1.8 million for a typical local authority, and further, that councils spend more than 80 per cent of their performance reporting effort on reporting ‘upwards’ and less than 20 per cent on their local systems; see Department for Communities and Local Government (2006), Mapping the Local Government Performance Reporting Landscape, Final Report. London: Department for Communities and Local Government.





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services

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