

**LOCAL GOVERNMENT AND REGENERATION COMMITTEE****PUBLIC SECTOR REFORM AND LOCAL GOVERNMENT****SUBMISSION FROM PROFESSOR JOHN SEDDON, MD OF VANGUARD  
CONSULTING****About Vanguard**

Vanguard helps service organisations change from a 'command-and-control' design to a 'systems' design. The Vanguard Method enables managers to study their organisation as a system and, on the basis of the knowledge gained, re-design their services to improve performance and drive out costs.

The Managing Director of Vanguard, Professor John Seddon is an occupational psychologist who began his career researching the reasons for failures of major change programmes. Based on what he learned, he has developed his own methods for change which he describes as a combination of systems thinking ('how the work works') and intervention theory (how to change it).

Vanguard has extensive experience of working with clients across all sectors. It has published many articles documenting the results achieved from the application of the Vanguard Method in public services, some of which are referenced below.

**The Vanguard Method – some selected results from the UK public sector**

UK local authorities who have rejected the central government guidance on how to manage housing benefits processing now deliver a service that puts official targets in the shade – and cut costs into the bargain. East Devon and Stroud councils, to cite just two, now process claimants' benefits in less than half the official 'target time', in a period when the number of benefits claimants was increasing (Middleton 2010). East Devon has serviced 33% more demand and Stroud has serviced 50% more, both with less resource. Blaenau Gwent has leapt from the bottom of the Welsh league table to the top; the improvement in housing benefits service has cut the number of 'benefits' calls to their service centre by 50% and face-to-face visits to solve benefits problems by 57% (Zokaei et al 2010). These are improvements and savings that would never have been put into a 'plan'.

Managers and employees at these councils – and others like them – have worked their way to a profound realisation: economy is in the flow of the work, not its scale. By learning how to design their services to meet citizen demands they have improved the services while driving out costs. Cost reduction is the consequence of their focus on purpose, in direct contrast to the political narrative which has cost-reduction as its *raison d'être*.

Believers in economy of scale assume that work should be treated as 'activity', and that 'activity' equals cost. This leads them to imagine that moving customer contact to call centres or the internet will be cheaper; and that creating back-offices and sharing services will provide opportunities to cut costs. But are they right to make these assumptions?

### **Shared Services: a no brainer?**

It seems obvious. If there are six organisations in the same field and each has an HR function, they should share the service and cut their costs. The amount of work would of course stay the same, but passing it through one organisation rather than six would require fewer buildings, managers, IT systems, suppliers and so on. Hence the notion that sharing services provides 'no brainer' opportunities for cutting costs.

In organisations, central costs such as HR and administration are conventionally allocated to operations, where the work is actually done. If these overheads are lower, transaction costs for the operations units must be lower too. To managers that makes sense, and it fits with another generally accepted view, the assumption that transaction costs are their most important concern. This is why shared services managers and consultants put so much emphasis on the relative virtues of the 'channels' customers use to access services, with telephone transactions being 'cheaper' than face-to-face, and internet transactions 'cheaper' than telephone ones.

The culminating piece in the logic of this kind of shared service-design is an IT system to link the front- and back-office, enable the channels, allow managers to control the activity of the workforce and facilitate the processing of work.

### **Three basic arguments**

These ideas constitute the three basic arguments for conventional shared services. The first two – which we might sum up respectively as 'less of a common resource' and 'efficiency through lower transaction costs' – originated in the economics literature. The third – IT as the enabler – is, of course, promoted by IT providers and scale consultancies.

The first is palpably obvious: achieving the same output for less of a given resource reduces cost. Many shared services projects are based on these kinds of savings alone. But such savings are not always easy to achieve in practice and anyway are relatively small

As an example, take IT. Consolidating IT is a common source of anticipated savings in shared services projects. An IT system may not be needed in the first place, and the features of systems typically procured by local authorities and housing services actually serve to increase the costs and worsen the quality of service. It is spurious to claim savings in one place when as a result costs are incurred somewhere else.

Can vacated buildings be sold? What are the costs associated with reducing managerial headcount?

Even shared service protagonists concede that less-of-a-common-resource savings are marginal. They make much higher claims for the second strand – improved efficiency through lower transaction costs. As well as lowered transaction costs (higher volumes of work achieved by the same infrastructure, cheaper channels), they promise efficiency gains through staff specialisation and work standardisation – ‘front offices’ to handle telephone calls and ‘back offices’ to actually process the work. The rallying cry is ‘simplify, standardise and then centralise’, using an IT ‘solution’ as the means.

On paper, this all seems to make sense. But how does it square with the evidence? The fact is that we are witnessing a mounting series of embarrassing and costly shared service failures.

Some, as in Western Australia, are a write-off from the start; they never get off the ground<sup>1</sup>. Many, like the UK Research Councils, have enormous teething problems, causing headaches for service users, who can’t get the service they want, and suppliers, who can’t get paid, alike<sup>2</sup>. Most, as with the Department for Transport, run massively over budget<sup>3</sup>. And when managers try to undo the deal, like the Somerset councillors attempting to get out of their South West One shared service centre, they discover that disengagement is prohibitively expensive. Western Australia, just one of many failures down under, had to take the full cost of disengaging, an eye-watering \$90m, on top of its failed investment of \$401m<sup>4</sup>.

Leaders in the public sector are all too often unaware that similar expensive failures have been racked up in the private sector. The difference, of course, is that private

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<sup>1</sup> Western Australia’s Department of Treasury and Finance Shared Service Centre promised savings of \$56 million, but incurred costs of \$401 million. See <http://www.erawa.com.au/cproot/9709/2/20110707%20Inquiry%20into%20the%20Benefits%20and%20CA%20with%20the%20Provision%20of%20SCS%20in%20the%20PS%20-%20Final%20Report.PDF> for more details (accessed 13/2/12)

<sup>2</sup> A National Audit Office report said that the UK Research Councils project was due to be completed by December 2009 at a cost of £79 million. But, in reality, it was not completed until March 2011, at a cost of £130 million. See <http://www.nao.org.uk/idoc.ashx?docId=23db711b-66fa-47be-9773-686ce60c0218&version=-1> (accessed 13/2/12)

<sup>3</sup> The Department for Transport’s Shared Services, initially forecast to save £57m, is now estimated to cost the taxpayer £170m, a failure in management that the House of Commons Public Accounts Committee described as a display of ‘stupendous incompetence’. The most recent evidence of the higher cost was documented in a House of Commons Transport Select Committee report (<http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtran/549/549.pdf> accessed 13/2/12)

<sup>4</sup> See <http://au.news.yahoo.com/thewest/business/a/-/wa/12365697/failed-oss-plan-will-swallow-extra-90m/> (accessed 13/2/12)

sector leaders take care not to parade their dirty washing in public. The private sector was initially sold shared services by the same economists and ‘scale’ consultants who now pepper official propaganda with projected savings from other ventures as grist to the mill – as when Western Australia’s projected savings were published in a Scottish Executive report extolling the virtues of sharing services!

It doesn’t help that civil servants take ‘evidence’ from such sources without validating it. They do so because policy is driven by ministers, and while ‘evidence-based policy is sought by government ... mostly the result is policy-based evidence’ (John Kay, ‘Darwin’s marriage and war in Iraq: the missing link’, FT 14 May 2008, p13). If anything, ministers are pushing the sharing of services harder, even as the evidence of failure mounts. At the time of writing, the minister for the Cabinet Office has made it clear that services will be shared across central government departments; the Cabinet Office has even established a framework agreement to enable departments to purchase the service directly, without the trauma of tendering. In Scotland, the 2009 Arbuthnott review recommended that 8 councils in the Clyde Valley area collaborate on a massive shared services programme (Arbuthnott 2009). Like many others, ministers believe in economies of scale and ‘digital by default’. Alas, they have been led astray by a common bias: as Kay has also noted, ‘Our intuitions about the merits of centralisation and scale are generally wrong’ (John Kay, ‘A real market economy ensures that greed is good’, FT 18/1/12).

### **Most large-scale IT projects fail**

Before I explain why bigger isn’t cheaper, it should be pointed out that the evidence is that the vast majority of large-scale IT projects fail, something the IT industry doesn’t talk about but that every manager, and minister for that matter, ought to know. In their aptly-titled book, ‘Dangerous Enthusiasms’, Gauld and Goldfinch (2006) provide a veritable tsunami of evidence to show that as many as 30 per cent of IT projects fail completely while a further 60 per cent go far over budget and/or fail to meet specifications. Western Australia is an example of the former, while the Department of Transport and UK Research Councils are examples of the latter.

The high rate of IT investment failure should be enough on its own to create a presumption against IT-driven change. But even when shared service ventures are implemented according to plan, they create costs in a more insidious way.

### **Managing costs causes costs**

Paradoxically, focusing on lowering transaction costs actually drives costs up. An early example of this phenomenon occurred when English local authorities were set a target to establish call centres by April 2005. When consultants were hired to help them move ‘telephone work’ over from council department, call volumes shot up. Why? The increase in call volumes was all ‘failure demand’ (Seddon 2003) – *demand caused by a failure to do something or do something right for the customer*. The assumption that telephone work can be usefully separated from service

provision is a classic case of misplaced faith in scale and centralisation; as a direct result call centres were stuffed with progress-chasing of various forms as people tried to put the two together again. Installing IT systems for what was called 'customer relationship management' (CRM) only served to institutionalise the waste.

Unfortunately, management's focus on transaction costs, fostered by the 'scale' consultancies, blinded it to the fact that while transaction costs were indeed lower, transaction numbers were inexorably rising as their system failed to provide service that worked for the customer. One reaction to increasing call volumes was (and is) to add more resource – hire more people to pick up the phones – which of course nullifies any gain from lower transaction costs. Another is to outsource call-handling to lower wage economies, ignoring the fact that contracts are commonly priced according to transaction volumes. Being paid by volume, outsource providers have no incentive to tackle high levels of failure demand, whose costs are thus locked in for the term of the contract. Many authorities are trying to move services to the web – 'digital by default' being the mantra – only to learn what they could have learned from their call centre experience: focusing on costs leads to a failure to focus on value, creating large amounts of waste in the form of failure demand.

We will return to focusing on value shortly. But first we need to examine how back offices have also driven costs up. The idea of the back office was first mooted by Richard Chase (Chase, 1978). He started from the premise that the job of a service manager was to maximise the use of resources, which in service consist largely of people. He observed that the customers often 'interfered' with the management process, interrupting work and preventing staff from working productively. So to maximise productivity, he proposed splitting the work between a front office, where customers' needs would be documented in some fashion (usually involving IT), and a back office, where labour could now be optimised without interruption. In this logic the back office provided a further opportunity for increasing productivity by standardising work and specialising the workforce, leading to reductions in operating and training costs.

Examination of what actually happens in such IT-dominated industrial designs reveals massive disruptions to the service flow; for the customer service is anything but smooth. There is huge waste in the shape of handoffs, rework, duplication of effort, and a focus on meeting activity targets and service levels. All these 'system conditions' lengthen the time it takes to deliver a service and consequently create failure demand. In other words, the service gets worse and the total cost of service goes up. On all counts such industrial designs fail miserably.

The most egregious example of this failure is Her Majesty's Revenue and Customs (HMRC) (whose amalgamation by Gordon Brown is another example of official obsession with scale and centralisation). HMRC has gone 'lean' and gone wrong. It is a classic instance of service industrialisation, based on the belief that taxation can

be mass-produced as in manufacturing. The work has been standardised and specialised. The management focus is on activity, not purpose. In a misguided attempt to create a performance culture, workers are set to solving management's wrong problem – why didn't we meet our targets yesterday?

While HMRC managers assure House of Commons select committees that lower transaction costs will bring improvements, the evidence is of mounting failure demand. Accountants have built web sites to complain about the number of transactions it takes to get a service. Even when callers to HMRC's call centres can get through they are left uncertain about the advice they have received. Advice UK, the umbrella for welfare advice organisations, has established that it is costing member organisations across the country at least £500 million to mop up failure demand (Advice UK 2008) downstream from HMRC and the equally dysfunctional Department of Work and Pensions (DWP).

Shared service ventures fail because they are based on 'industrial' designs featuring IT-led service factories that promise economies of scale. Scale thinkers mistakenly think that the fact that some channels are inherently cheaper than others is more important than the design of the service, thus unwittingly causing failure demand. They are equally wrong in assuming that lower transaction costs will lead to improvement, when the total number of transactions it takes customers to get a service is rising. Based on the central idea that costs are associated with activity, service managers bear down on exactly the wrong lever and drive their costs up.

### **Managing value drives costs out**

Yes, some channels are indeed cheaper than others – but which channels can work for which services? Booking a squash court works online if the website is designed from the user's point of view. Most public services are infinitely more complex than that. Yet children's services, adult social care, housing benefits and planning (development control) have all been moved to industrial shared service designs, with disastrous consequences.

Computers are simply not flexible enough to absorb the variety and complexity of demand faced by most public services. People, and only people, are. With a thorough understanding of demand from the customers' point of view, the human expertise required to serve that demand is created at the point of transaction. All of the case studies Vanguard has published illustrate this basic principle. All employ measures that relate to the purpose of the service from the customers' point of view, and these measures are used where the work is done to understand and improve service delivery. Working this way focuses on managing value, not cost. Another paradox: focusing on value drives costs out.

### **The better way to share services**

To return to our six organisations and their HR functions: the first step in sharing services is to study the service where it is, and the second to improve it, again in situ. In cases where this has been done, HR productivity has as much as doubled (Middleton 2010). For IT help-desks, productivity has risen by 20 per cent while service has improved (ibid). These examples illustrate the counterintuitive truth that true economy comes from flow, not scale. Having achieved significant improvement, managers can then, and only then, consider whether further economies can be achieved by using less of a common resource – the third and final step.

Compared to conventional IT-led industrial shared service attempts, this better approach avoids all the risks associated with planned change; indeed, the risks are eliminated through the first step – developing knowledge – and subsequently using that knowledge to improve. Those improvements are realised in months.

Careful study of industrialised shared service designs reveals the important truth that industrialisation itself is the flaw. What becomes immediately apparent is that standardised, IT-driven factory processes are incapable of absorbing the variety of customer demand, making it a struggle for customers to get what they want. When customers can't get what they want (especially in public services where there is no alternative) they return until they do. Failure demand of this kind represents a massive hidden cost. It can run as high as 80 per cent of all customer demand in industrialised shared services projects, locking in costs for many years.

Understanding this and other problems with industrialisation leads to a better approach: placing the (human) expertise required to solve people's problems at the place where they meet the service provider, usually locally. Instead of being processed by demoralised and disengaged workers in remote computer-controlled factories, citizen needs are understood and acted on by enthusiastic, helpful people who are motivated by providing a service that both matters and works. Overall costs tumble because citizens need fewer transactions to get a service, irrespective of channel. Ironically, this is a lesson that does come from manufacturing. It was first learned by Taiichi Ohno, the architect of the Toyota Production System, in the 1950s: that the economies that matter are achieved through flow, not scale.

### **Specifications and inspection**

In the public sector, much waste is caused by the practice of central specification and then inspection to ensure compliance with these specifications. Instead, we need a new philosophy of regulation. Currently, the centre (whether Whitehall or from the Scottish Government) dictates what is to be reported by services. These specifications serve to constrain and dictate the design of public sector work. In turn, this demoralises frontline workers who recognise that the specifications are preventing them from doing the right thing for their 'customers' (whether benefit claimants, children in social care or patients in hospital), but are made to comply

through rigid targets and 'guidance'. What writers like Dan Pink (Pink 2009) have taught us is that there are 3 qualities that need to be present in a system to maximise personal commitment rather than compliance:

- Autonomy – the ability for individuals to be able to act with choice.
- Mastery – the individual having a clear sense of the developing personal competence and contribution to the whole.
- Transcendent Purpose – The individual's clear sense of a purpose larger than themselves to which they make their contribution.

If we want to engage the brains and the efforts of public sector workers, we therefore need to shift the locus of control from the centre to the workers in the frontline.

Regulators should move to help services to decide the purpose of a service so that there are not arguments over that. Inspectors must then go to see the work in situ. They should then ask the service workers and managers to talk through their method of working, and the measures that they have chosen to understand and improve their work. By allowing freedom over choice of method, the workers are given the necessary level of autonomy to reengage their motivation. The centre can then free up the resources that were previously engaged in producing the reams of specifications, saving millions.

The current specifications regime has fostered compliance rather than innovation, and compliance with wrong-headed ideas to boot. We need to rid ourselves of the specifiers who dream up bad ideas, and inspectors who ensure compliance. It is time to make the managers who deliver the services responsible rather than compliant, an essential prerequisite for innovation.

### **Benchmarking best practice: 'Better' is a more constructive lodestar**

'Best practice' is a static idea. It leads us to think we should copy others. Father of the Japanese post-war revival W. Edwards Deming taught that copying without knowledge is dangerous. The genius behind the development of the Toyota Production System Taiichi Ohno taught that visiting others was looking in the wrong place. He showed how everything you need to know to improve your organisation is within it; you simply need to learn how to look at it differently.

Benchmarking 'best practice', in the sense encouraged in local authorities – visiting others – is the fastest way to mediocrity.

Anything can be improved, even the best. 'Better' is a dynamic idea and is therefore a better lodestar for local authorities' performance management.

### **Examples of multi-agency partnership working**

In Portsmouth, housing tenants experience exemplary services (Seddon and O'Donovan 2012). This work won a MIX (Management Innovation Exchange) prize from Gary Hamel at The World Innovation Forum in 2011 (Hamel and LaBarre 2010). Property repairs are completed either on the day required by the tenant or within less than a week (compared with the official target of 28 days). Private-sector suppliers have more than halved their costs per repair and the city council's housing department operates with 12% less resource – more numbers than no one would dare to put in a 'plan'. Portsmouth's design has been developed in conjunction with its private-sector suppliers – a pocket of excellence in strategic partnerships that goes against the grain of guidance on partnerships coming from the centre.

In the field of adult social care, adherence to the specifications developed by government means the time it takes to determine an adult's needs is extraordinarily long, requires multiple visits by different functions and is confusing for the adults requiring help. For example, in one local authority (O'Donovan 2010) it was learned that for every £100 spent on care £1,000 was spent in administration (establishing the need for this care to be provided). While all of the functions within this service may be meeting their targets, and the service may be highly rated by inspectors, the customers' experience was dreadful. Often those who need care suffer deterioration in their conditions.

In Somerset, a newly redesigned service now has a collaborative NHS/local authority team comprising of occupational therapists, physiotherapists, care workers and social workers trying to pick up referrals of patients in the community from GPs or acute hospitals (Caulkin 2011, 'You and Yours' 9/2/12). This team then focuses on understanding the patient's individual context before doing things to try to 'rebalance' their situation at home, allowing them to be returned to independent living as soon as possible. Examining the experiences of a sample group of patients showed that, in 70% of the cases, people were being trapped in the system by non-medical problems: as they presented themselves to the health service with a problem, they were being given a health service solution that did not satisfy their real, more general requirement for help. They discovered that their services had been focussed on 'doing things better' in each silo, whilst the new design allowed for people to concentrate on 'doing better things'.

For example, an elderly lady had multiple admissions to hospital and was labelled as 'vulnerable' after several falls at home. When the redesigned team took time to understand her home context, they found she was falling because she was reaching away from her walking frame in order to close her curtains in the evenings. Understanding this problem, the team were able to provide her with a longer piece of equipment that would allow her to close her curtains, preventing the falls. Understanding takes time upfront. But this is a small price to pay for a move from 'doing things better' to 'doing better things' that takes service and its cost into a

dimension that is incomprehensible to those stuck in the old model. As in the case above, the material costs of rebalancing are laughably small, while the savings elsewhere in the system are uncountable. For 93 people discharged from the Somerset service, there were 12 prevented hospital admissions, 25 reduced stays, six prevented admissions to long-term care homes and 29 reduced packages of care, let alone numberless assessments, appointments and other transactions that didn't need to happen. This is without considering the positive benefits to all of the service users.

Local authorities that have studied their systems have used this knowledge to design the service against demand and hence improve the service – people get their problems solved in short times – and this reduces costs in three ways: the costs of administration, the costs of equipment provided and, by far the largest saving, the costs associated with driving people into care homes/the wider NHS system.

In Great Yarmouth, the local authority's housing department believed that demand for local social housing outstripped supply (The Systems Thinking Review, 2011). All requests for housing were assessed as to their level of priority and added to the waiting list. However, applying the Vanguard Method led them to an extraordinary discovery: only 15% of the demand hitting their system actually had a high housing need. High housing need of itself does not mean that that the solution should be social housing. Often people asking for help only wanted help with a deposit so that they could move into private accommodation or needed help to solve a dispute involving a private landlord. There are a huge range of solutions that can be tailored to solve each particular problem. The council transformed their team from performing the function of placing all requests onto a database to one which helps people to solve their various housing problems, saving £140k on IT costs along the way.

### **Getting knowledge**

Managing value requires, first of all, thorough knowledge about citizen demands. Understanding demand *in citizens' terms* (what do they want and need from the service?) leads to knowledge about the expertise required to service those demands. Deploying that expertise at the point of transaction gets the work done faster and more efficiently. This is real efficiency saving: better services with lower costs. As we have discussed, by focusing on providing what customers want costs are driven out; cost-reduction is a consequence, not a focus for management.

The principle is infinitely replicable. Take potholes, for example. Whether in the UK (Edinburgh [Middleton 2010], Cumbria [The Systems Thinking Review, 2011]) or New Zealand (Central Otago [Middleton 2010]), experience shows that designing road repairs against demand at least doubles productivity. This astonishing improvement begins by understanding demand from the roads and equipping repair personnel with the wherewithal to take responsibility for an area. The designs rip out all the unproductive activity associated with the current (mandated) designs, with

massive savings in administration costs. Repair costs tumble as the potholes are filled in.

**Only people can absorb variety**

Just as someone who knows an area is equipped do a better job of road repair, someone who knows their community can provide it with more appropriate (better) services. Back to Stroud, where people working in the benefits office see their job as helping people solve their problems, not just administering benefits – a perspective it would be impossible to take in a fragmented scale design. Or Stockport, where IT help-desk people use their knowledge of demand not only to give fast solutions to problems but more than that, to resolve the issues that caused the problems. In these designs morale rises and the symptoms of poor morale – sickness and absence – fall.

There's another important and unexpected consequence. When citizens experience good service their behaviour changes. They not only have good things to say about their council (and send employees flowers or cakes instead of brickbats), they begin to behave more responsibly in their own communities. Visitors to Portsmouth's estates are struck by their appearance and the culture amongst residents. The economic value extends beyond cost-savings. Better services create better communities; the moral economics outweigh even substantial financial benefits.

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