



State Agency Reorganizations:

Rationales, Points of Inquiry, Implementation Issues

Testimony before the Senate Committee on Health

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The brief was prepared in response to a request from the Senate Committee on Health for information on reorganization proposals to guide the committee's analysis and assessment of reorganization options. For additional copies of this brief, visit our website at www.library.ca.gov/crb. For additional information or questions, please contact Toby Ewing at tewing@library.ca.gov.

Madam Chair and Members,

Thank you for the opportunity to present testimony to the committee as you consider proposals to reorganize health-related departments and reduce costs. The California Research Bureau was founded to provide expert, nonpartisan research and analysis to state policymakers to support their deliberations.

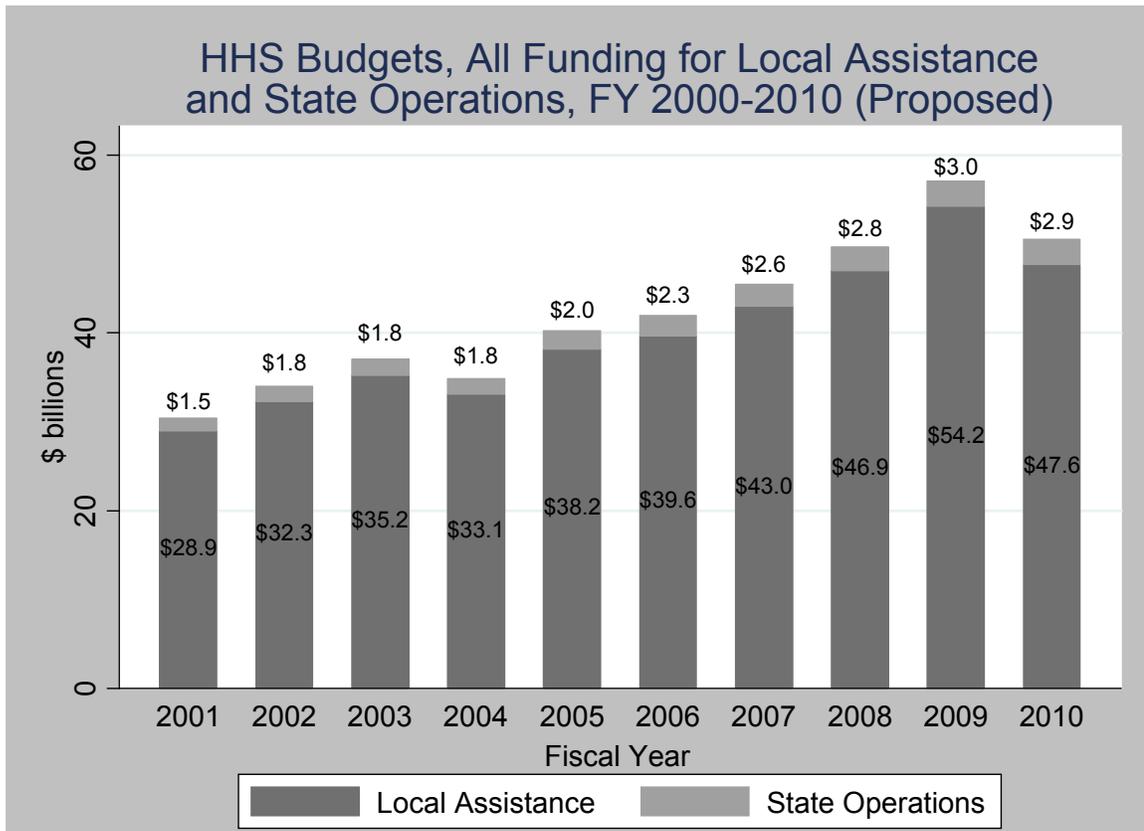
This report provides an overview of lessons learned from prior reorganizations, drawing heavily from analyses performed by the Little Hoover Commission, along with academic literature analyzing federal reorganizations, private-sector mergers, consolidations and related efforts.

In response to the Committee's inquiry, this testimony addresses two issues:

1. General lessons on agency reorganizations. Evidence suggests that a majority of reorganizations or mergers do not result in anticipated cost savings or improved outcomes. Reorganizations typically reduce administrative costs with nominal savings, but often have not led to the fundamental restructuring that can realize significant cost reductions. Reorganizations can result in significant cost savings, but to do so they must be strategic, well managed and designed to improve service delivery systems, which in turn improve outcomes and reduce expenses over the long term. The legislature has other tools that can be more effective in reducing costs and improving outcomes.

2. Issues to consider when exploring reorganization options relating to health and human services. The vast majority of state funding for health and human services is spent on local assistance. State operations represent a small percentage of overall state costs. The Committee should consider options to achieve cost reductions in local assistance that have minimal impact on service delivery, including streamlining state reporting, integrating funding streams and better integrating services to improve outcomes. Evaluation of state-level reorganization proposals should assess whether reforms would better leverage funding for state operations to drive improvements in local assistance.

HHS Budgets, All Funding for Local Assistance and State Operations, FY 2000-2010 (Proposed)



Source: Legislative Analyst's Office. State of California Expenditures, 1984-85 to 2009-10. http://www.lao.ca.gov/laoapp/laomenus/la_menu_economics.aspx. Accessed June 5, 2009.

PUBLIC AGENCY REORGANIZATIONS

Historically, in California and elsewhere, public agency reorganizations have been put forth to reduce costs, better integrate services, establish new priorities, streamline reporting, eliminate redundancies or shake up organizational structures.

For the 2009-10 fiscal year, the Governor has proposed a number of organizational changes that draw upon the work of the California Performance Review and recommendations from prior reform efforts. The Legislature also has directed staff to explore additional options for consolidation or reorganization that make policy sense.

These proposals are driven by the scale of California's fiscal crisis and a budget deficit for the 2009-10 fiscal year that is estimated at more than \$24 billion.

Based on reviews of the literature and analysis of related work, the California Research Bureau has highlighted three

Recent Reorganizations and Reorganization Proposals

- ✓ Consolidation of departments into the California Department of Corrections and Rehabilitation
- ✓ Creation of the Office of the Chief Information Officer
- ✓ Establishment of the Department of Public Health
- ✓ Consolidation of numerous boards and commissions
- ✓ Creation of the Labor and Workforce Development Agency

concerns that policymakers should consider in deliberating on any reorganization proposal:

1. Reorganizations can be costly and do not necessarily result in cost savings. The reorganization process itself can increase short-term costs, as state offices are relocated, staff are required to undergo new training, and technology and administrative systems are taxed to respond to new organizational designs. Organizational change also can exacerbate conflict among state entities, as organizations with differing identities, histories and organizational cultures are forced together. Those conflicts may undermine efforts to integrate public services, thus thwarting efforts to improve public outcomes and reduce service delivery costs.

2. Organizational change is a blunt tool; other tools may be better suited to meeting cost reductions or policy goals. Organizational design is indeed important, but it matters in the larger context of a clear mission, efficient administrative practices, strong oversight and other internal processes. Structure helps but does not drive performance or costs. Other tools that may be better suited to reducing costs, improving outcomes and prioritizing policy goals include results-based budgeting, enhanced personnel practices, improved legislative oversight, and better public oversight, particularly at the level of the service delivery system, which often is handled through local governments.

3. Managing transformational change is difficult and requires sustained leadership and support from the executive and legislative branches. Redesigns that have consistent internal and external support are more likely to succeed than reforms with only cursory or short-term political support. Reorganizations that lack that high-level support, particularly from the Governor and Legislature, are unlikely to realize significant cost savings or improve outcomes as ongoing policy and funding decisions undermine the new organizational design.

LESSONS LEARNED

The history of reorganizations – in the public and private sectors – is mixed. In testimony to the Little Hoover Commission in 2004, Lenny Mendonca, President of the Bay Area Economic Forum and Chairman of the McKinsey Global Institute indicated that 70 percent of change efforts in the private sector are ineffective because of organizational inertia. Similarly, Susan Robison, a consultant with the National Conference on State Legislatures on health and human service programs, reported to the Commission that state agency reorganizations typically do not result in cost savings or program improvements.

Based in part on those poor results, scholars have not been able to put forth an agreed upon framework for deciding when to reorganize. But a number of lessons have emerged that can guide reorganization decisions:¹

- **Leadership for organizational redesign must come from the top.** Successful reorganizations require initial and enduring support from the Governor.
- **System-wide change cannot be accomplished in one step.** Reforms require a strategic approach, must be carefully managed, and should be designed to realize early successes that build confidence and ongoing support among policy leaders, stakeholders and other constituencies.
- **An open process produces better outcomes.** Stakeholders must be able to contribute to and build ownership of the reorganization process if they are expected to lend support. Stakeholders must understand and believe in the goals of reform to support changes.
- **The executive and legislative branches must agree on reforms and work together over time to achieve fundamental improvements.** To build trust, address concerns and promote confidence in the plan as it moves forward, the executive branch reforms must have the support of legislative leaders.
- **Employees also must be involved.** For organizational transformation to be successful, people throughout the organization must understand the goals of change and their role in accomplishing that change. They must be given clear and consistent messages that change is essential to organizational success.

DISPARATE RATIONALES

Scholars also point out that the rationales behind reorganization proposals vary. Thus it can be difficult to put forth a set of general conditions for success that apply under each rationale.

Peter Szanton, former Associate Director of the U.S. Office of Management and Budget, and Fellow with the Institute of Politics at Harvard University, outlines six reasons for reorganizing government. The first three, he argues, are not worth the effort.²

1. Reduce costs. Cost reduction is a key rationale behind many proposals to reorganize public-sector agencies. Yet scholars point out that most reorganizations result in small reductions in administrative costs rather than fundamental restructuring of service delivery systems that could achieve significant cost savings.

2. Shake up organizations. Transformational change is akin to surgery, with all the accompanying anxiety. Bureaucracies and the stakeholders who support them have and will successfully resist change that is simply designed to shift authority. The costs, complexity and resistance that reorganizations encounter make this justification insufficient to support a reorganization plan.

3. Simplify organizations. Government is by nature complex and cannot easily be simplified. California state agencies promote employment, purchase health care services, protect public health and safety, care for the vulnerable, and ensure the quality of work environments, water, food and air. These are not simple tasks that can be lumped or split simply to streamline organizational structures.

But Szanton asserts that reorganization may be justified to address three other goals:

4. Symbolize new priorities. For example, establishing the Department of Homeland Security allowed the President to focus political and bureaucratic efforts on public safety. California's reorganization of the Department of Corrections and Rehabilitation was premised on fortifying rehabilitation strategies – among other reasons – within that agency.

5. Improve the effectiveness of programs. Organizations develop internal cultures that resist change and can thwart efforts to improve programs. Organizational reforms can be an effective strategy for overcoming cultural resistance to other reforms that have a strong mission-drive rationale.

6. Promote policy integration. Many public agencies work toward conflicting goals, such as the competing pressures to contract for health care services while also regulating health care providers. Many disparate agencies work toward shared goals, but find collaboration difficult across departments. Organizational reforms that bring together disparate efforts under shared leadership can result in improved outcomes if that leadership can resolve the tensions between competing priorities. For example, the Little Hoover Commission's work on foster care identifies barriers to cooperation between child welfare, mental health, education and other programs with shared clients and shared goals.

Szanton's review of federal reorganizations – and similar lessons from past reform proposals in California – suggest that organizational reforms are difficult, costly and require a clear analysis of whether proposed changes would result in sufficient benefits to justify the disruption and expense. For instance, many of the proposals coming out of the California Performance Review were criticized by

stakeholders and policymakers for lacking sufficient justification.

The analysis advocated by Szanton and others would include an assessment of how best to address particular challenges and realize specific goals. Reform proposals that target cost savings, improved effectiveness and enhanced accountability might benefit from alternative strategies in addition to organizational change.

Public management scholars Patricia Ingraham and Amy Kneeder suggest that the integration of management systems – including fiscal, personnel, information technology and capital management systems – is key to supporting outcome improvements and reducing costs.³ These strategies can occur within or apart from organizational considerations. But these scholars point out that fiscal crises that pit these management systems, or different organizational divisions, as competitors – rather than allies – can undermine their integration and disrupt performance.

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The work of Szanton, Ingraham, Kneeder and others suggests that the analysis of the strategic potential of a reorganization proposal would thus:

- 1) Identify organizational goals.
- 2) Identify the challenges facing the organization.
- 3) Assess the costs and benefits of a range of responses, including organizational, policy, management and programmatic reforms.
- 4) Ensure that reforms, structural or otherwise, will pull together management systems to address shared goals.

ADDITIONAL CONSIDERATIONS

Organizationally, state government is complex. The “functions” of government – even those within just the executive branch – vary substantially.

To perform these various functions, the government has multiple tools, including direct and indirect services and tools, such as regulations, tax expenditures and financial incentives. Based on the required functions and tools, organizations can be designed to achieve efficiencies or encourage improved outcomes.

State governments, and California’s government in particular, are complicated by the diversity of sometimes conflicting functions and geographic and demographic scale. Organizationally, there are three important issues, particularly in health and human service fields.

1. State-local responsibilities. Because of the demographic, geographic and related scale issues, California often relies on local governments, usually counties, to deliver state programs. But this relationship is often characterized as having more conflict than cooperation. Public policies are permeated by funding disputes and blame games, and the struggles of state vs. local control and state vs. local priorities. While the organization of state entities should be designed based on the State's functional responsibilities in these areas, it often is not. To improve performance, parts of the State's organizational structure must be premised on the State's role in an improved state-local relationship. But to do so, state-local realignment must precede state reorganization.

2. State programs must work together. To be effective, many state programs need to work together. No matter how many programs are consolidated into super-departments, the super-departments will still need to work together. This is important, because a reorganization that seeks to reduce fragmentation through consolidation alone without coordinating the efforts of the consolidated departments will face new challenges. In addition, if the only solution to fragmentation is consolidation, then departments may become too big to be effective. For example, health and human service programs will always need to coordinate with education, employment and correctional agencies.

3. Some roles conflict. State government has many roles that inherently conflict. Organizational structure must separate those conflicts, while providing a means for resolving disputes at the appropriate level. Generally speaking, government relies on boards and commissions where it needs to provide some independence, such as the role of the Mental Health Oversight and Accountability Commission or the Mental Health Planning Council. In the past, policymakers have traded direct and immediate accountability to the Governor in exchange for a structure that can withstand undesirable political influence and is better suited for public, fact-based decision making. But government architects have been less effective at developing venues or procedures for resolving the inevitable disputes that arise from public agencies that are pursuing conflicting missions in the same policy area. One example would be the Department of Social Services which licenses and monitors the quality of board and care facilities while also overseeing county efforts to ensure an adequate supply of those facilities.

Government functions have evolved faster than structures.

Over the last century, government has fundamentally changed what it is trying to do (e.g., combat drugs, deliver education for all). Government also has developed new tools to pursue those goals (e.g., more grants, more contracting with third-party entities, such as

non-profit organizations).

In some cases the structure has been aligned to respond to changing needs. In other cases it has not. In many cases, the evolution has not been strategic. That is to say, policymakers have not fully resolved how new programs should be integrated with existing programs, or they did not pick the most effective tool for the task.

The first issue of a Reorganization – where to begin. One approach would be to detail the functions of the departments under review and align the form or organizational structure to those functions. At the very least, this approach requires a fairly detailed analysis of the functions in a particular agency, of the departments within the agency, and of the branches and even programs within departments.

The analysis must be detailed because part of the organizational structure will group activities based on subject matter, such as health. But even within health, the state has multiple, often conflicting functions. For example, the state regulates the quality of healthcare and it is the largest single purchaser of healthcare. Elsewhere, the government seeks to put natural resources to use, and to protect those resources from harm. State government encourages economic development and protects consumers. To assess even the existing functions requires a detailed understanding and description of what the government is presently doing.

According to the “re-engineering government” movement from the 1990s, reform must begin further upstream. Public leaders must determine what functions they want the public sector to provide – and which ones they should stop doing. Peter Hutchison, a noted authority on public-sector management and organization, has recommended a similar approach to bringing expenditures in line with revenue: Rank the outcomes that are most important; fund the activities that are most likely to generate those outcomes. Stop funding those activities that do not support those outcomes or are at the bottom of the priority list.

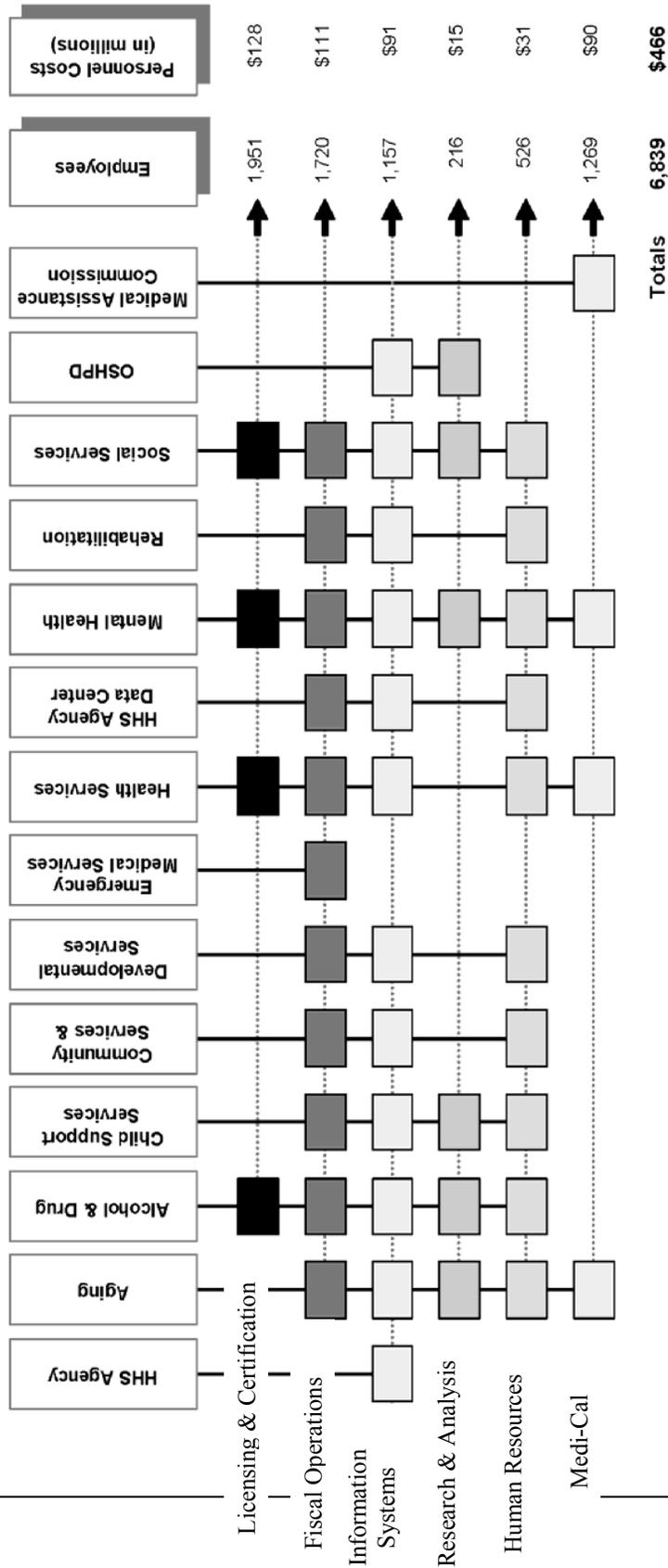
Having determined what functions are desired or required, policy-makers must then select the “tool” that government should use to perform that function. In some cases, government actually provides the service. For instance, the Department of Mental Health delivers mental health care through a network of state hospitals. But in other cases, the State extends that responsibility to local government, or that service is contracted out to the private sector (most often a nonprofit agency). In some instances, these arrangements have been selected deliberately and strategically, and in many cases they have evolved (or not evolved) based on tradition or the crisis of the

moment.

In 2004, the Little Hoover Commission undertook a review of California's Health and Human Services Agency. In earlier reviews of mental health and social service programs, the Commission determined that state operations were not aligned with local services. Duplicate functions across multiple health and human services departments increased local costs and undermined local efforts to deliver tailored and integrated services that were known to be most effective in responding to public needs.

In the analysis, the Little Hoover Commission documented multiple, shared functions across departments within the Agency and recommended organizational reforms to better leverage state operations to improve the effectiveness and the efficiency of local assistance funding.

Duplication of Functions Among Select Health & Human Service Departments



Reproduced and modified from: California Little Hoover Commission, *Real Lives, Real Reforms: Improving Health and Human Services*, Report 173 (Sacramento: the Commission, May 2004), p. 40. Data on number of employees and personnel costs reflect FY 2002-03, as reported in the original.

The Little Hoover Commission's recommendations called for integrating the administrative functions of a number of state agencies to enable local agencies to streamline their reporting and related activities. The Commission also recommended bolstering the capacity of the Agency to coordinate efforts across departments.

The California Research Bureau has not reviewed or updated the Commission's work to reflect changes in the organizational structure of the Agency since the Commission's analysis in 2004. But the Commission's work does serve as a framework the Committee could consider in assessing reorganization options. The premise behind the Commission's work, consistent with CRB's analysis, is that for organizational reforms in health and human services to generate significant savings, they must be designed to improve the efficiency or effectiveness of local programs and thus reduce local assistance costs.

1 Richard D. Young. 2003. *State Restructuring and Implementation: Issues and Strategies*. USC Institute for Public Service and Policy Research. Peter Szanton (ed.) *Federal Reorganization: What Have We Learned?*

2 *Peter Szanton, editor. 1981. Federal Reorganization: What Have We Learned?* Chatham, NJ: Chatham House.

3 Patricia W. Ingraham and Amy Kneeder. 2000. "Dissecting the Black Box: Toward a Model and Measures of Government Management Performance." In Jeffrey L. Brudney, Laurence J. O'Toole, Jr. and Hal G. Rainey, eds., *Advancing Public Management: New Developments in Theory, Methods, and Practice*. Washington, D.C.: Georgetown University Press.