Conceptualising 'Value' in Public Sector Strategy

Tatiana Zalan
Senior Lecturer
International Graduate School of Business
University of South Australia
City West Campus, Way Lee Building
North Terrace, Adelaide, South Australia, 5001, Australia
Tel +618 8302 7170
Fax +618 8266 0604
Tatiana.Zalan@unisa.edu.au

Geoffrey Lewis
Professorial Fellow
Melbourne Business School
200 Leicester Street Carlton Victoria 3053
Tel + 618 83620621
g.lewis@mbs.edu

ABSTRACT

We overview the most recent intellectual developments in the fields of strategic management and public administration to evaluate whether ideas about business strategy can help managers in the public sector become more 'strategic'. In recent years business strategy and public administration have converged on the idea of value creation as the purpose of both business enterprises and public sector entities. Unlike business strategy, the field of public sector administration lacks clarity about how to define, operationalise and measure 'value'. We conclude that direct importation of strategic management concepts to the sector is problematic and suggest that public sector studies may benefit from an infusion of economic concepts regarding 'public value' to lend much needed conceptual rigour and empirical evidence.

Key words: strategic management, public sector, value creation, public value

Acknowledgement: Some sections of the article draw on our working paper *Strategy: From Profit to Value.*

Conceptualising 'Value' in Public Sector Strategy

The motivation for our paper is the question frequently asked by our MBA students and practicing managers from government organisations – whether, and to what extent, concepts and frameworks from business strategy are applicable to their sector. Accordingly, the purpose of the article is to map the most recent intellectual developments in the fields of strategic management in the public sector and evaluate whether ideas about business strategy can help managers in the public sector[i] to become more 'strategic'.

In recent years strategic management and public administration appear to have converged on conceiving the purpose of the business firm and the public sector entity as value creation. While the notion of the purpose of the business firm as quest for value is not new (see our subsequent discussion where this idea is explored in detail), it gained traction since the mid-1990s. At that time, Adam Brandenburger and Barry Nalebuff, proponents of the application of game theory to strategy, in their 1996 book *Co-opetition* explicitly recognised that for a firm to claim value, it must first create it. A business firm's unique added value came to be understood as the value created by all participants in a transaction minus the value that could be created without it – put simply, it is the difference that a firm makes to the world (Montgomery, 2008). It should be noted at the outset that understanding value creation as the purpose of the firm's strategy is fundamentally different from the traditional strategic planning approach (e.g., Andrews, 1971; also Mintzberg, 1994). Rumelt (2011: 8) describes a modern reincarnation of this traditional approach as "a template-style system of strategic planning" – filling in The Vision, The Mission, The Values and The Strategies boxes with generic, non-actionable statements of the obvious (e.g., popular 'visions' of being the best, the leading or the best known and aspirations relabelled as 'strategies').

In the public sector, in the mid 1990s Mark Moore put forward a ground-breaking proposition about 'public value' being the focus of strategy in the public sector, and public sector managers being stewards of public assets with "restless value-seeking imaginations" (see Moore, 1994; 1995). The notion of public value has been embraced by the world of practice: for example, the BBC deployed it as a central organising principle in the major review to its operations conducted in 2004, naming the review *Building Public Value* (see Alford and O'Flynn, 2009: 181). Hence, the fundamental issue in strategic management in for-profit firms and public sector entities has become how to adequately conceptualise and operationalise 'value'.

In recognition of this convergence on the idea of 'value', this paper, firstly, overviews the way 'strategy' is conceptualised in the world of business and then moves on to discuss the notion of public value and management in the public sector. Acknowledging the differences that exist between business and the public sector, we demonstrate why a direct importation of strategic management concepts (e.g., value added, surplus, price) to the public sector remains problematic. This issue, even though for different reasons, is well recognised in public sector studies: for example, Moore (2000, p. 186) notes that "strategy developed in the business world is not a frame that can be easily carried over into the public world of nonprofits, and that leaders in these organisations would be better served by adopting a different model altogether" (see also Nutt and Backoff, 1993; Ring and Perry, 1985). The argument is that public sector managers need different approaches and frameworks that will guide them in their quest for creating public value.

Strategy in the Business World

Common misconceptions in the public sector studies

Our review of the literature indicates that public sector administration studies present a rather dated understanding of the purpose of the firm, the notion of what constitutes 'value' and, more generally, 'strategy' in the private sector. For example, quoting Michael Jensen, one of the proponents of the shareholder value maximisation doctrine, Moore (2000: 186) suggests that "by law and social convention, the purpose of publicly held for-profit companies is understood to be the maximisation of shareholder wealth". This is clearly at odds with how the purpose of the firm is thought of in the field of business strategy today.

On the issue of 'value', Oster (1995: 139) argues that the principal value delivered by the for-profit business is the financial returns delivered to the shareholders and the 'use value' delivered to customers, with both aspects of value being reasonably well measured by the financial performance of the firm. This conceptualisation of value equates 'value' with financial returns, possibly because at that stage of conceptual development it was difficult to measure 'use value'. Elaborating on the tasks of a strategist in the private sector, Alford (2001: 4) lists "(1) producing the kinds of goods and services desired by customers (i.e., the most useful, the best quality, etc.): (2) producing as much of them as desired; and / or (3) doing so at minimal cost and hence at the lowest price to customers". It would appear that the main job of a strategist in a private firm is addressing the supply-demand and pricing problems for a commodity whose 'value' is reduced to its functional value.

Further, nearly all public sector administration studies which refer to strategy in the private sector make an unhelpful distinction between strategy formulation and strategy implementation, clearly working off the old 'strategic planning' paradigm. This paradigm, while popular in the 1960s-1970s, has no theoretical underpinnings, and, with the importation of rigorous microeconomic concepts since the early 1980s (e.g., industry attractiveness; resources, activities and dynamic capabilities as sources of rents, etc.) has run its course (see, for example, Mintzberg 1994; Campbell and Alexander, 1997; Martin, 2010b). Given these misconceptions, a useful starting point would be to clarify how 'strategy' is conceptualised in the world of contemporary business.

Value creation as the purpose of the business firm

The field of strategy evolved from a 'business policy' / strategic planning phase (Andrews, 1971) - an atheoretical approach informed by observations of business practice (see Porter, 1982; Ghemawat, 2002) when the fact that a firm outperforms others was explained in terms of alignment between the opportunities and threats in the external environment (considered in terms of key success factors) and an internal evaluation against these KSFs of the strengths and weaknesses of the organisation itself. These strengths and weaknesses were distilled into what Andrews referred to as a set of 'distinctive competencies'- a firm's assets and capabilities, reputation and history that enabled the firm to be better than its competitors. Starting from the late 1970s-early 1980s, strategy was reconceptualised as the search for superior profits, underpinned by the premise that the sole purpose of the firm is to maximise shareholder value (Jensen and Meckling, 1976). The importation of concepts from industrial organisation economics – most notably, by Porter, encapsulated in his five forces framework (Porter, 1980) – and other economic theories focussing on a firm's unique resource endowments and dynamic capabilities (e.g., Dierickx and Cool, 1989; Barney, 1991; Teece *et al.*, 1997) brought much needed theoretical rigour to explaining the firm's superior financial performance in terms of industry structure and resource positions.

The newer idea on why firms exist harks back to Drucker's view that the purpose of the firm is 'to create a customer', as part of the process of creating unique value. As Drucker stated, "the business is defined by the want the customer satisfies when he or she buys a product or service. To satisfy the customer is the mission and purpose of every business" (Katrow, 2009). This idea anticipates Martin's (2010a) argument about the advent of 'the age of customer capitalism' to replace the age of shareholder capitalism – based on empirical evidence, he argues that shareholders actually do better when firms put the customer first.

Maximising shareholder returns is an obligation (to providers of capital) and a constraint (i.e., what a firm needs to do to survive), but it is not the purpose of the firm (Campbell and Alexander, 1997). Business practitioners agree: Jack Welch, who during his two-decade tenure as CEO of GE was seen as the exemplar of the shareholder value maximisation doctrine, became one of its strongest critics. Welch (cited in Denning, 2011) states: "On the face of it, shareholder value is the dumbest idea in the world. Shareholder value is a result, not a strategy…your main constituencies are your employees, your customers and your products. Managers and investors should not set share price increases as their overarching goal…Short-term profits should be allied with an increase in the long-term value of a company".

A rigorous conceptualisation and operationalisation of 'value' as the purpose of the business firm started to develop in the 1990s, when Brandenburger and Stuart (1995) and Brandenburger and Nalebuff (1996) defined a firm's unique value added as the value created by all participants in a transaction (customers, suppliers, employees and many others) minus the value that could be created without the firm. A further breakthrough in our thinking about strategy as value creation came in the late 1990s-early 2000s, with the development of a rigorous conceptualisation and quantification of value-added and competitive advantage, the central concept in strategy (see Ghemawat and Rivkin, 2006; also Rumelt, 2003; Halaburda and Rivkin, 2009; Postrel, 2010; Collis, 2011). Fig. 1 summarises how 'strategy' is thought of today from a positioning perspective.

--- Insert Fig 1 here----

Starting from the premise that the purpose of the firm is to create unique value – and, if the firm creates more value more effectively than competitors, it will generate superior returns – strategy involves 'positioning' decisions (Porter, 1996; also Collis and Rukstud, 2008), that is, choices about:

- the *Who*, *Where and When* (the customers that will be served);
- the *What* (a unique Value Proposition aimed to meet specific customer needs – Functional and Emotional); and
- the *How* (resources and activities and the way they are arranged) – the business system (model) that will be used to deliver the Value Proposition to the target customer segment.

A firm's competitive advantage is thus thought of in terms of unique *added value*; a firm can boost its added value by widening the wedge it achieves between what its customers

are *willing to pay* (before switching to a substitute or foregoing the purchase altogether) and *costs*, with both WTP and costs being **relative** to a firm's competitors (Ghemawat and Rivkin, 2005). A unique Value Proposition creates a relative higher WTP; strategic cost management ensures Economic Costs are at the minimum level by aligning all the firm's activities behind the delivery of the carefully defined Value Proposition. Because competitive advantage, defined in terms of added value, is transaction-specific (i.e., specific to particular circumstances of customer, time and place) (see Postrel, 2010), the popular strategy formulation-implementation dichotomy is meaningless (Martin, 2010b), at least as anything other than a planning tool.

Within this framework *Price* is a strategic variable that business managers can use to partition the added value into two components: (1) *buyer surplus* (the difference between a customer's WTP and price) and (2) *producer surplus*, or firm profit (the difference between price and cost) (Besanko *et al.,* 2007). A firm can change the Price in the short term to alter the balance between producer and buyer surplus – Price does not affect competitive advantage (although it may be an element of Value Proposition). The notion of Consumer (or more generally Buyer) Surplus is particularly important, because this is what drives consumers' buying decisions and, ultimately, value creation – if consumers do not buy a product or service, then no value has been created.

While the neoclassical economics informing contemporary strategy theory has implicit in it *'homo economicus'*– rational, optimising decision-making man, research in behavioural economics (e.g., Thaler, 1992; Tversky and Kahneman, 1974; also Poundstone, 2010), informed by cognitive psychology, psychophysics and neuroscience, sheds light on what actually determines 'value'. Numerous psychological experiments reveal that people are unable to estimate 'fair' prices and hence 'value'. For example, in their classic 1974 *Science* article, Tversky and Kahneman theorised that an initial value – the 'anchor' (however arbitrary) – serves as a mental benchmark for estimating an unknown quantity. For strategists, the implication is that establishing appropriate price 'anchors' is critical to boosting a buyer's willingness to pay and, therefore, opening up a wedge of a firm's competitive advantage. Long before behavioural economists, Thorstein Veblen (1899/1973), an institutional economist and one of the progenitors of the social theory of value, suggested that no good was purchased merely on its ostensible efficacy in the use intended (i.e., for its functional value proposition); each purchase was a statement about the individual engaging in the transaction. The founder of the Austrian School of economics, Carl Menger (1871/ 1976, p. 121), stated that "[v]alue is …nothing inherent in goods, no property of them, nor an

independent thing existing by itself. It is a judgment economising men make about the importance of the goods at their disposal for the maintenance of their lives and well-being. Hence value does not exist outside the consciousness of men”. Value in the business world, therefore, is not an ‘objective’ reality, but inherently subjective, contingent, hermeneutic and negotiable (Mirowski, 1990).

Thus, through embracing concepts from microeconomics, the field of business strategy achieved considerable progress in conceptualising and operationalising the notion of ‘value’ and ‘competitive advantage’ (defined in terms of value added by a firm relative to competitors). There is also a recognition that externalities (e.g., R&D spillover effects and pollution) need to be accounted for in the quantification of a firm’s competitive advantage. Because markets are inefficient at valuing such externalities, technical issues associated with pricing these goods remain a significant challenge for academics and strategists.

Strategy in the Public Sector

A theory of public value

In his seminal book *Creating Public Value: Strategic Management in Government,* Mark Moore (1995) proposed what is now being touted as a ‘theory of public value’ (Try and Radnor, 2007) and an ‘alternative strategy model’ (i.e., alternative to the private sector) which resonates powerfully with the experience of nonprofit managers because it focuses attention on social purposes (Moore, 2000, p. 183). This framework was developed through years of engagement with public managers from the U.S. and around the world who took part in executive programs at Harvard’s John F. Kennedy School of Government (Bennington and Moore, 2011). Even though not without its critics (e.g., Rhodes and Wanna, 2007), the centrality of Moore’s model to conceptual developments in public sector management is unquestionable (see Alford and O’Flynn, 2008).

The key argument – embodied in the so-called ‘strategic triangle’ – is that public value creation, the primary task of a public sector manager, necessitates an alignment between three distinct but interdependent processes (Bennington and Moore, 2011: 4), which seem to be granted equivalent status (Williams and Shearer, 2011):

- *Defining public value* – clarifying and specifying the strategic goals and public value outcomes;

- *Authorisation* – creating the 'authorising environment' necessary to achieve the desired public value outcomes, via a coalition of stakeholders from the public and private sectors; and
- *Building operational capacity* – harnessing and mobilising the operational resources (finance, staff, skills and technology) both inside and outside the organisation.

While each of these three factors is strategically important, they are rarely believed to be in alignment, hence one of the challenges facing public managers is to strive to constantly bring them into alignment and negotiate workable tradeoffs between them.

It would appear that this conceptualisation of 'strategy' in the public sector has much in common with the Andrews' (1971) idea of seeing business strategy as a matter of alignment between a firm's distinctive competences with the opportunities and risks it faces in the external environment. Andrews' framework emerged from observation of businesses – that is, what successful businesses actually did – and was not informed by theory. It is noteworthy that Andrews himself never referred to his framework as a 'model', let alone a 'theory', but simply as an "informing idea" (Mintzberg, 1994: 36).

Subsequent conceptual contributions to the theory of public value (see Stoker, 2006; Alford, 2001; Kelly *et al*., 2002), including in non-U.S. contexts, can be summarised with reference to Fig. 2 (for a detailed discussion, see Blaug *et al*., 2006). Public value is clarified and authorised by the public, who define value through their preferences. The three principal sources of public value include high quality services, outcomes reflecting public priorities (e.g., social inclusion, public health), and trust between citizens and the government, which is an essential element in the legitimation of government action. Public sector organisations mediate (shape and accommodate) the relationship between the public and public value, making sure that resources are effectively allocated, reflecting the values of both equity and efficiency. The value that government intends to produce for its stakeholders and for society at large is defined by an organisation's mission (Moore, 2000), hence the mission becomes the metric (usually set out in substantive, rather than financial terms) that is used in judging past performance and assessing future courses of action (Bryce, 1992). We concur with Williams and Shearer (2011), who conducted a comprehensive review of the public value literature, that this framework does not appear to be grounded in any theory or research tradition, hence lacks testable propositions (see also Morrell, 2009). To complicate the lack of theoretical rigour, the most striking feature of the public value studies is the relative absence of empirical investigation of either the normative propositions of public value or its efficacy

as a framework for understanding public management (Williams and Shearer, 2011). While the theoretical rigour of business strategy has improved considerably with the importation of concepts from economics (see above), it would seem that the public value framework is likely to remain an a-theoretical, albeit useful, pedagogical tool for public sector administration (see Williams and Shearer, 2011, p. 1381).

---Insert Fig.2 here---

Proponents of the new approach to public sector management through the lens of public value theory argue that public value thinking can help to define, clarify and operationalise the notion of adding value to the public sphere, in the same way that the concept of added value within the private market provides a benchmark for private sector activity (Bennington, 2011). If this is the case, the question then arises – how is 'value' conceptualised and operationalised in the public sector?

Conceptualisating 'public value'

As even a scant review of the literature reveals, there appears to be little agreement on precisely how 'public value' should be conceptualised in the first place – as Alford (2001: 5) notes, "there is much debate about what public value is and should be". One way of thinking about public value is to include: (1) the provision of legal framework which underpins law and order and providing the pre-conditions for the operation of the market (e.g., reinforcing property rights); (2) remedying various kinds of market failure, through the provision of public goods, intervening to counter negative externalities, minimize transaction costs and curb excessive market power; and (3) the promotion of equity (Alford, 2001: 5). Kelly *et al.* (2002) contend that public value can be generally defined as what the public is willing to make sacrifices of money and freedom to achieve.

Bennington (2011) offers a different conceptualisation of public value as having two dimensions: (1) what the public values and (2) what adds value to the public sphere. On the issue of what public values, Moore (1994: 302) states that "[p]rimacy in defining public value must be reserved to citizens and their representatives acting through the collective processes of government. What public managers must seek to satisfy are the collective aspirations expressed through the political process – not the aims of professionals, not the wishes of clients. They must become agents of collective rather than individually defined purposes". Such public value is defined and re-defined through political interactions. The second dimension of public value – what adds value to the public sphere - can be further decomposed into (Bennington, 2011):

- *economic value* – adding value to the public realm through the generation of economic activity and employment;
- *social and cultural value* – adding value to the public realm by contributing to social capital, social cohesion, social relationships, social meaning and cultural identity, individual and community well-being;
- *political value* – adding value to the public realm by stimulating and supporting democratic dialogue and active public participation and citizen engagement;
- *ecological value* – adding value to the public realm by actively promoting sustainable development and reducing public 'bads' like pollution, waste, and global warming.

The concept of public value has also been examined through the lens of economic theory (for a review, see Bozeman, 2002), and, more specifically, the influential market-failure and public goods model, pioneered by Samuelson (1954) and Bator (1958). Economists seem to agree that there are six conditions under which markets in a mixed economy (i.e., a mix of private and public sectors) fail, in the sense that they are not perfectly competitive and hence not Pareto-efficient[ii]: (1) failure of competition; (2) public goods; (3) externalities; (4) incomplete markets; (5) information failures; and (6) unemployment, inflation and disequilibrium. These conditions provide a rationale for government activity (Stiglitz, 2000). Public goods have the properties of being non-rivalrous (one person's consumption does not reduce the benefit of another's consumption) and non-excludable (when one person consumes, it is impossible to prevent another individual consuming the good). Under strict conditions no market can exist for these goods, so governments need to fund the provision and protection of such goods through taxation (Morrell, 2009). The market failure model centres on issues of externalities / spillover effects (as causes of market failure) and, more generally, on the ability to set efficient prices for goods and services. In recognition that market-based frameworks are inadequate to the social allocation of goods and services, alternative public interest and public-value failure models emerged, yet, akin to the market failure theory itself, they tend to rely on an "unmeasured ideal concept" (Bozeman, 2002, p.157). It should be noted that 'public goods' are not synonymous with 'the public good' (i.e., a shared benefit at a societal level), even though there is a conceptual overlap, as the fair and efficient provision of public goods contributes to the public good, and vice versa (Morrell, 2009). Some scholars within this tradition, echoing public management academics (e.g., Moore, 1995), argue that government and democratic political institutions create value, as they reduce transactions costs, encourage efficient exchange of political rights and design

social institutions (Kirlin, 1996). Public value has also been conceptualised as 'social surplus', or the sum of producer surplus and consumer surplus (Cowling, 2006). This definition comes closest to value added in business strategy (see above), yet it is unclear how (and by whom) the total social surplus can be meaningfully partitioned, given that the price mechanism is either distorted or absent.

Finally, consultants view public value through the lens of a performance management framework (see Alford and Flynn, 2008), where public value becomes "the value created by government through services, laws, regulations and other actions" thereby developing a rough yardstick against which to gauge the performance of policies and public institutions (Kelly *et al.*, 2002: 4). Cole and Parston (2006: 65) (both of Accenture), for example, define value as "producing a basket of outcomes desirable to stakeholders and doing so cost-effectively". In the process, 'strategy' becomes confused with operational efficiency – re-engineering, quality management and benchmarking – a point made by Porter (1996) in business strategy and Frumkin and Andre-Clark (2000) in the context of public sector organisations.

A further issue in public sector strategy is that entities are faced with a strategic dilemma of providing value to various stakeholders through politically negotiated tradeoffs. Tradeoffs resulting from satisfying the needs of stakeholders with multiple, and often conflicting, objectives, suboptimise the final outcome. As Martin (2010a) explains with reference to for profit firms and linear programming reasoning, only one strategic objective can be maximised at any one time[iii]. A way of breaking out of this dilemma in the public sector is to clearly conceptualise value which can then be divided through a process of bargaining.

Clearly, the field of public sector management remains distant from a unified understanding of what constitutes public value. As argued cogently by O'Flynn (2007: 358), "[d]iscussing public value has become increasingly popular, however, a clear definition remains elusive", making public value little more than a "catch-all label for a series of loosely connected prescriptions for improvement" (Williams and Shearer, 2011: 1377). Further, unlike mainstream business strategy, an unambiguous conceptualisation of public value firmly grounded in theory is lacking. This is surprising, given that 'value' occupies a central place in economic thought and is indeed indispensable for understanding the workings of the modern capitalist system (Heilbroner, 1983; Lowe, 1981).

Measuring 'Public Value'

While researchers and public sector practitioners have developed a vast array of methods – for example, the cost-benefit analysis in transport, QALYS and DALYs (quality of disability adjusted life years) in health policy and clinical interventions, as well as highly sophisticated methods of capturing both direct and indirect effects of an intervention (Mulgan, 2011), the operationalisation and measurement of public value remains problematic. The first difficulty is that there exists significant disconnect between 'outputs' (input/output ratios and productivity) and 'outcomes' (what value is being added, by whom, for whom and how) (see Bennington, 2011). The well publicised New Zealand public sector 'experiment' of the late 1980s aimed to force accountability and responsiveness on a public service system highlighted a chasm between easily measurable outputs (specified in terms of quality, quantity and timing, controlled through budgets and plans) and difficult to quantify desired outcomes (Norman, 2011). For example, outputs in higher education institutions (e.g., research publications and teaching scores) are disconnected from public value outcomes (e.g., enhancing the national human capital and cultivating life-long learning). A focus on outputs leads to arbitrary control and performance management systems which are completely divorced from underlying value and can be gamed so that they become pointless. In such instances, public value, as aptly described by Alford and O'Flynn (2008), becomes a "performance management story", and broader notions of public value become marginalised in the quest for efficiency (O'Flynn, 2007: 363). Other difficulties of measuring public value are explained with reference to Fig. 3.

---Insert Fig 3 about here ---

Problem of measuring WTP. Unlike in the private sector, where measures of WTP (such as contingent valuation and total cost of ownership) are relatively well established and conceptually non-controversial, there exist significant philosophical, technical and political impediments to developing useful measures of public value. Thus, the philosophical problem arises because the question of what constitutes public value is essentially a normative question: public value consists of achieving some **collectively** defined social outcomes (Moore and Bennington, 2011: 264), hence the problem of aggregating individual preferences arises, particularly in pluralistic societies (see Bozeman, 2002). In general, there are two established techniques to measure WTP for non-market goods (see McVittie et al., 2009, Table 2): (1) calculating revealed preferences, or what people actually consume; and (2) looking at stated preference, or what people say they value. As revealed preferences do not

reflect accurately the quality of experience, the more common approach, imported from welfare economics, is to look at stated preferences using the WTP (to maintain a given level of public good provision) or the WTA metric (i.e., willingness to accept a public good of a lower quality). For example, an individual may be willing to pay £200 in higher taxes to maintain a bus service to her village, but may require a tax rebate of £500 for a complete withdrawal of the bus service (Cowling, 2006). In many situations, WTP becomes 'ability to pay': the question *How much are you willing to pay for the medical treatment that will save your child's life?* is meaningless[iv], as you will pay whatever you have (or can). In these instances measuring value becomes particularly difficult and often highly controversial.

As a surrogate measure of WTP, differential pricing can be used – as, for example, in insurance, where high income earners pay higher insurance premiums to cover the costs of services. The provision of fundamental services (water, electricity, education, etc.) uses value-based pricing which is heavily distorted by government subsidies. Value-based pricing in electricity, for example, is a situation where 'pricing' is at the lower end of the Demand curve in order to ensure the less well off are not denied access to an essential service. Thus, the WTP curve becomes, in effect, the ability to pay curve. Buyer surpluses are delieverd to all those above the equilibrium price; a producer deficit is associated with supplying all those on the demand curve between the 'set price' and the equilibrium price.

Price. The other difficulty in operationalising and measuring public value is that public sector entities cannot be (fully) compensated through the price mechanism, because these products and services are usually heavily subsidised or free, hence prices are distorted. Market prices cannot be used in two instances: (a) when outputs and inputs are not sold on the market, such as clean air or natural wilderness; and (b) when there is a market failure. Whenever there is a market failure, shadow (social) prices may be used in instances where there are true social costs and benefits, reflected imperfectly in the market price. In the absence of a market failure, the price of a good equals its opportunity cost – for example, the shadow price of labour when there is massive unemployment is the low value of the foregone leisure (see Stiglitz, 2000, p. 283). In Fig. 3, Price (Point A) is set such that services are available even to the most disadvantaged groups. In the absence of a robust price mechanism, we should nevertheless be attributing WTP to ensure appropriate allocation of resources in the public sphere. It is likely that the buyer surplus – the value above the equilibrium price – exceeds the supplier deficit, that is, the value between the equilibrium price and the set price.

Problem of supply. Public goods and services can be either in over supply (e.g., pollution, a negative externality) or under supply (e.g., clean environment, a positive externality); hence the basic policy problem arises due to the inability to collect a return or be remunerated for the supply of a good (McVittie et al., 2009). In Fig. 3 above, the Supply is above / left of the Price/Demand curve intersection. This means that the government has to cover the gap between point A and point B.

Crucially, there remain significant gaps in the researchers' and practitioners' ability to capture fully aspects such as the value people place on fairness, democracy and the process by which the public is engaged and consulted (Cowling, 2006). Mulgan (2011: 215) remarks that "economic models of thinking about public goods and externalities, though informative, are often inadequate to the real choices faced by policy-makers and out of sync with public attitudes and politics". It remains unclear, though, what the current alternatives are to the economic logic, if we are to uncover the ultimate foundations of public value.

Drawing a parallel between business strategy and public sector management, the former made significant progress when it was understood that 'value' existed only at the transaction level. These transactions are aggregated for practical purposes, limiting what strategists can do conceptually and analytically. Public value, it would seem, continues to be conceptualised at the aggregate level, which will inevitably limit subsequent theoretical and empirical progress. Such conceptualisation represents a political science perspective on value – useful for political analysis, yet inadequate for strategic analysis.

Comparison with the Private Sector

To conclude this section of the paper, and in keeping with the tradition of the public sector studies, we summarise how business strategy concepts play out in the public sector (Table 1). As the differences highlight, a direct importation of strategic management concepts from the business strategy field to the public sector is of limited value.

---Insert Table 1 here---

Conclusion

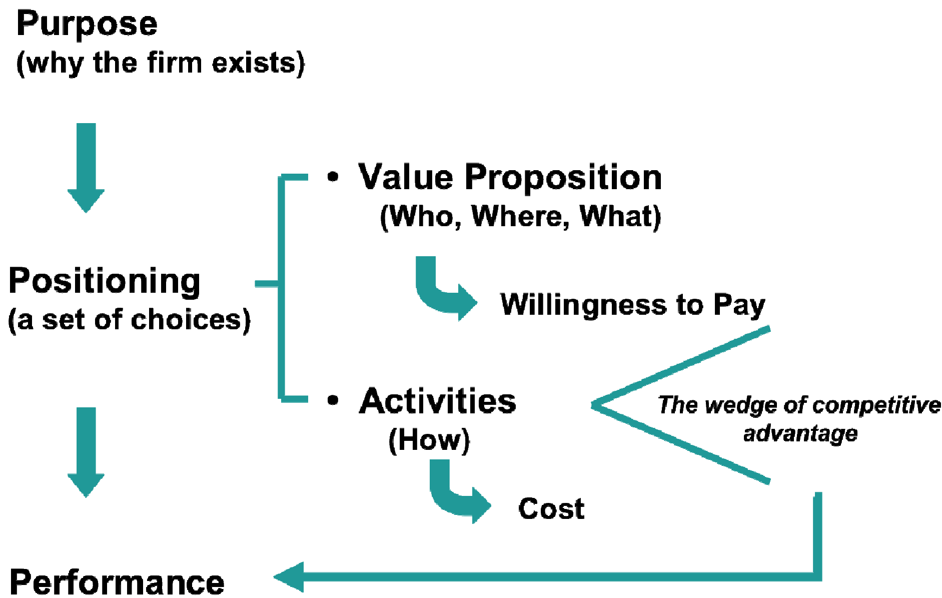
Our discussion of the concept of 'strategy' and its key concept, 'value', in the public sector has shown that at present the latter is poorly defined, lacking theory and empirical support. To paraphrase Rumelt (2003), an influential professor of business and society (who was frustrated with how loosely the concept of 'competitive advantage' was defined in strategy), the public sector area is in need of a clear definition of public value, or it needs to stop

employing the concept that cannot be defined. The question “What is public value?” needs a conceptually sound and analytically robust answer.

Unless a clear answer to this question is given, and until we impute a value for publicly available goods and services, there will be no strategy in the public sector, at least in the way it is understood in the business world. The field of public sector management today, it would seem, is where business strategy was in the late 1960s-early 1970s – a collection of scant empirical evidence awaiting theory. We suggest that, just as the field of business strategy has benefited from an infusion of economics to lend much needed conceptual rigour and empirical evidence, the field of public administration can draw more freely on economic concepts, at least as a starting point. Subsequent theoretical and empirical advances, incorporating more sophisticated treatments of ‘public value’, may build on these foundations.

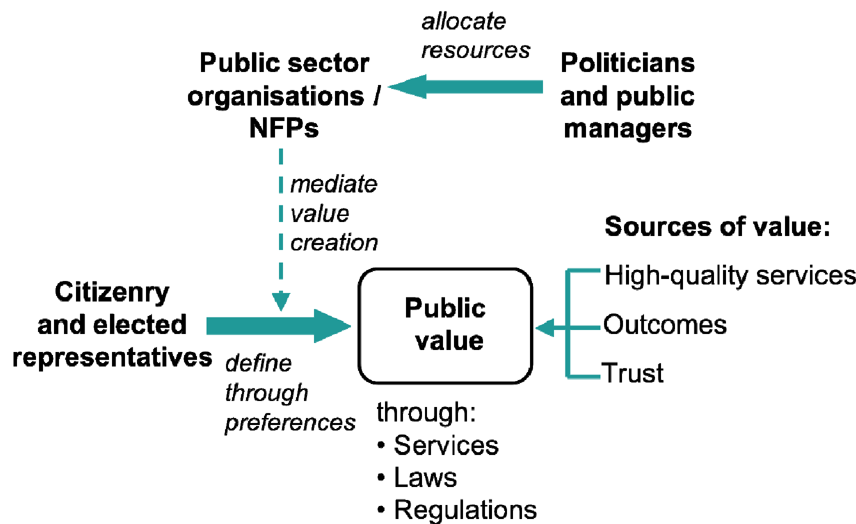
FIGURES

Figure 1 – Summary of strategy concepts



Source: Lewis and Zalan (2012)

Figure 2 – Summary of public value model



Source: Authors, based on Blaug, R., Horner, L. and Lekhi, R. (2006) *Public Value, Politics and Public Management. A Literature Review*, The Work Foundation.

Fig. 3 – Supply, Demand and Prices in the Public sector

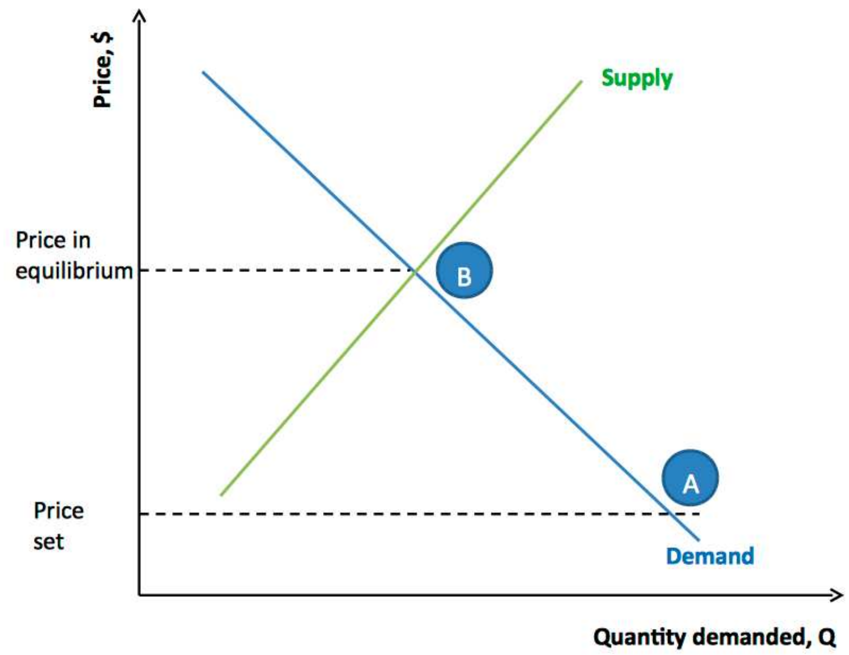


Table 1 – Strategy in the private and the public sector

	Private sector	**Public sector**
Choice	Economic choices are made through the market (price) system.	Social choices are made through the voting (political) system.
Market	Free market	No free market, a hypothetical market needs to be constructed to elicit value judgements.
Industry / competition / firm environment	Industry analysis techniques help managers to understand how a firm should be positioned in an industry to create value and capture some of that value as profit.	Government-created monopolies preclude competition. The model can be useful if providers of public services are part of a private supply chain (or vice versa) and where competition from private providers exists.
Value creation and capture	Value creation AND capture (as profit)	Entities, while creating value, do not (fully) capture it as their profits – and often operate at a deficit to meet the needs of an 'ability to pay' demand curve.
Who defines value	Generally, the customer – if customers do not buy products or services, then no value has been created (only costs added).	Citizens and their elected representatives (this is an ideal model, which often leaves citizens frustrated by the perceived failure of the elected representatives).
Value conceptualisation and operationalisation	Total value created in a transaction is the difference between a customer's WTP for the product / service and a supplier's opportunity cost. Price divides this amongst the participants in a transaction (the transaction is the fundamental unit of analysis).	Clarity on how to define, operationalise and measure public value is lacking. Aggregate level of conceptualisation dominates the field.
Competitive advantage	Transaction-specific differential economic surplus, or the wedge between a customer's WTP and cost (both relative to competitors)	The concept has limited applicability to the sector.
WTP	WTP measurement techniques are well established (although often difficult to apply).	WTP measurement techniques do exist, but are deficient. Willingness to accept, ability to pay, value-based pricing and differential pricing are surrogates. No integration of these concepts.
Cost	Activity-based costing could be used to measure costs relative to competitors. Acceptance of concept of economic cost.	Same principles may apply (although economic costs rarely used).

Price	Managers have the ability to use Price to divide Value into consumer and producer surplus depending on the strategy they are pursuing (e.g., maximising growth or profit).	The price mechanism is inefficient – driven by political considerations and 'ability to pay' demand curves rather than by markets.
Sources of revenues	Sale of product and services.	Charitable contributions, tax appropriations, fees (and combinations of these).

References

Alford, J. (2001) The implications of 'publicness' for strategic management theory, In: G. Johnson and K. Scholes (eds.) *Exploring Public Sector Strategy*, Harlow: Prentice Hall, pp. 1-16.

Alford, J. and O'Flynn, J. (2008) *Public value: A stocktake of a concept*. Paper presented at the 12th Annual Conference of the International Research Society for Public Management. Brisbane, April.

Andrews, K.R. (1971) *The Concept of Corporate Strategy*. Dow Jones-Irwin, Homewood. IL.

Barney, J. (1991), Firm Resources and Sustained Competitive Advantage, *Journal of Management*, 17, 99-120.

Bator, F. M. 1958. The anatomy of market failure. *The Quarterly Journal of Economics, Vol. 72, No. 3 (Aug., 1958), pp. 351-379*, 72 (3): 351-79.

Bennington, J. (2011) From private choice to public value? In: Bennington, J. & Moore, M. H. (eds) *Public Value: Theory and Practice*, London: Palgrave MacMillan, pp. 31-51.

Bennington, J. and Moore, M. H. (2011) *Public Value: Theory and Practice*, London: Palgrave MacMillan.

Besanko, D., Dranove, D., Shanley, M., & Schaefer, S. 2007. *Economics of Strategy*. Hoboken, NJ: John Wiley & Sons.

Blaug, R., Horner, L. and Lekhi, R. (2006) *Public Value, Politics and Public Management. A Literature Review*, The Work Foundation.

Bozeman, B. (2002) Pubic-value failure: When efficient markets may not do, *Public Administration Review*, March/April, 62(2), 145-161.

Brandenburger, A. and Nalebuff, B. (1996) Co-opetition. New York: Currency.

Brandenburger, A. M. & Stuart, H. W. 1996. Value-based business strategy. *Journal of Economics & Management Strategy*, 5(1): 5-24.

Bryce, H. (1992). Financial and strategic management for nonforprofit organisations. Englewood Cliffs, NJ: Prentice Hall.

Campbell, A. and M. Alexander. 1997. What's wrong with strategy? *Harvard Business Review* (November-December): 42-44, 46, 48-51.

Cole, M. and Parston, G. (2006) Unlocking Public Value. A New Model for Achieving High Performance in Public Service Organizations. Hoboken, N.J.: John Wiley & Sons, Inc.

Collis, D. and Rukstad, M. 2008. Can you say what your strategy is? *Harvard Business Review*, April.

Collis, D. (2011) Quantitative analysis of competitive position: Customer demand and willingness to pay. *Harvard Business School Module Note 9-711-495*.

Cowling, M. (2006) *Measuring Public Value: The Economic Theory*. The Work Foundation.

Denning. S. (2011) The dumbest idea in the world: Maximizing shareholder value, *Forbes*, 28 November. www.forbes.com/sites/stevedunning

Dierickx, I. and Cool. K. (1989) Asset stock accumulation and sustainability of competitive advantage, Management Science, 35(12):1505-1511.

Frumkin, P. and Andre-Clark, A. (2000) When missions, markets and politivcs collide: Values and strategy in the nonprofit human services. Nonprofit and Voluntary Sector Quarterly, 29(1): 141-163.

Ghemawat, P. and Rivkin, J. 2006 Creating competitive advantage, *Strategy and the Business Landscape. Text and Cases*. Upper Saddle River, New Jersey: Pearson Prentice Hall.

Ghemawat, P. 2002. Competition and business strategy in historical perspective. *Business History Review*, Spring: 37-74.

Halaburda, H. and Rivkin, J. W. 2009. Analysing relative costs. *Harvard Business School module note 9-707-462*.

Heilbroner, R. (1983) The problem if value in the constitution of economic thought, *Social Research*, 50(2), Summer, pp. 253-277.

Jensen, M. C. & Meckling, W. H. 1976. Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial economics*, 3: 305-60.

Katrow, A. M. (2009) 'Why read Peter Drucker', *Harvard Business Review*, November.

Kelly, G., Mungan, G. and Muers, S. (2002) *Creating Public Value. An Analytical Framework for Public Service Reform*. Strategy Unit, Cabinet Office.

Kirlin, J. J. (1996) What government must do well: Creating value for society, *Journal of Public Administration Research and Theory*, 6(1): 161-185.

Lewis, G. and Zalan, T. (2012) *Strategy: From Profit to Value*. Melbourne Business School working paper.

Lowe, A. (1981) Is economic value still a problem? *Social Research*, 48(4), Winter, pp. 786-815

Martin, R. (2010a) The age of customer capitalism, Har*vard Business Review*, January/February, pp. 2-8.

Martin, R. (2010b) The execution trap, Harvard Business Review, Jul-Aug, 88:64-71.

Martin, R. (2011) *Fixing the Game*. Boston: Harvard Business School Press.

McVittie, A., Moran, D. and Thomson, S. (2009) *A Review of Literature on the Value of Public Goods from Agriculture and the Production Impacts of the Single Farm Payment Scheme*, Land Environment and Research Group.

Menger, C. (1976). *Principles of economics*. (J. Dingwall & B. E. Hoselitz, Trans.). New York: New York University Press. (Original work published 1871).

Mintzberg, H. (1994) *The Rise and Fall of Strategic Planning*. NY: The Free Press.

Mirowski, P. (1990) Learning the meaning of a dollar: Conservation principles and the social theory of value in economic theory, *Social Research*, 57(3): 689-717.

Montgomery, C. (2008) Putting leadership back into strategy. *Harvard Business Review*, January: 54-60.

Moore, M. (1995) *Creating Public Value: Strategic Management in Government*, Cambridge, Mass: Harvard University Press.

Moore, M. (2000) Managing for value: Organizational strategy in for-profit, nonprofit, and governmental organizations, *Nonprofit and Voluntary Sector Quarterly*, 29(1): 183-204.

Moore, M. H. (1994) Public value as a focus of strategy, *Australian Journal of Public Administration*, 53(3): 296-303.

Morrell, K. (2009) Governance and the public good, *Public Administration*, 87(3): 538-556.

Mulgan, G. (2011) Effective supply and demand and the measurement of public and social value, In: Bennington, J. & Moore, M. H. (eds) *Public Value: Theory and Practice*, London: Palgrave MacMillan, pp. 212-224.

Norman, R. (2011) Redefining 'public value' in New Zealand's performance management system: Managing for outcomes while accounting for outputs, In: Bennington, J. & Moore, M. H. (eds) *Public Value: Theory and Practice*, London: Palgrave MacMillan, pp.202-211.

Nutt, P. and Backoff, R.W. (1993) Organizational publicness and its implications for strategic management, *Journal of Public Administration Research and Theory*, 3(2): 209-231.

O'Flynn, J. (2007) From new public management to public value: Paradigmatic change and managerial implications. *The Australian Journal of Public Administration*, 66(3): 353-366.

Porter, M. (1982) Industrial organisation and the evolution of concepts for strategic planning, in: Thomas H. Nyler (editor), 'Corporate Strategy, Amsterdam: NorthHolland, pp. 183-196.

Porter, M. E. (1980) *Competitive Strategy*. New York: Free Press.

Porter, M. E. (1991) Towards a dynamic theory of strategy, *Strategic Management Journal*, 25: 95-117.

Porter, M. E. (1996) What is strategy? *Harvard Business Review*, November-December: 61-78.

Postrel, S. (2010) *Competitive advantage and the surplus landscape: A synthesis*. Merage School of Management, University of California at Irvine working paper, March.

Poundstone, W. 2010. *Priceless*. New York: Hill and Wang.

Rhodes, R. and Wanna, J. (2007), The Limits to Public Value, or Rescuing Responsible Government from the Platonic Gardens, *Australian Journal of Public Administration,* 66(4): 406-421.

Ring, P. S. and Perry, J. L. (1985) Strategic management in public and private organizations: Implications of distinctive contexts and constraints, *Academy of Management Review*, 10(2): 276-286.

Rumelt, R. (2000) The perils of bad strategy. *McKinsey Quarterly*, June:1-7.

Rumelt, R. (2003) What in the world is competitive advantage? UCLA Policy working paper, Policy Working Paper 2003-105.

Rumelt, R.P., Schendel, D., and Teece, D. J. (1991) Strategic management and economics, *Strategic Management Journal*, 12:5-29.

Samuelson, P. A. 1954. *Review of Economics and Statistics,* XXXVI(November): 387.

Stiglitz, J. E. (2000) *Economics of the Public Sector*, New York/London: WW Norton & company.

Stoker, G. (2006), Public Value Management: A New Narrative for Networked Governance? *American Review of Public Administration,* 36 (1): 41-57

Teece, DJ, Pisano, G. and A. Schuen 1997. Dynamic capabilities and strategic management. S*trategic Management Journal,* 18(7): 509-533

Thaler, R. H. 1992. *The Winner's Curse: Paradoxes and Anomalies of Economic Life.* . Princeton: Princeton University Press.

Try, D. and Radnor, Z. (2007) Developing an understanding of results-based management through public value theory, 20(7): 655-673.

Tversky, A. and Kahneman, D. (1974) Judgment under uncertainty: Heuristics and biases. *Science*, 185(4157): 1124-31.

Veblen, T. (1899/1973) *The Theory of the Leisure Class. Introd. John Kenneth Galbraith*. Boston: Houghton Mifflin.

Williams, I. and Shearer, H. (2011) Appraising public value: Past, present and futures, *Public Administration*, 89(4): 1367-1384.

Endnotes

[i] In this paper we focus on the government sector only. Given the significant heterogeneity of the not-for-profit (NFP) sector, we believe that implications for NFPs may be different from the ones discussed in the paper, and may constitute a topic for future research.

[ii] Resource allocations that have the property that no one individual can be made better off without someone being made worse off are said to be Pareto efficient, or Pareto optimal (see Stiglitz, 2000).

[iii] For example, growing market share and improving current profitability are conflicting objectives in a business firm, so only one can be maximised at a particular point in time.

[iv] In reality, economists and governments do have to put a value on individual health and life, even though there may not be market prices for these goods. For example, while there is virtually no limit to the amount that could be spent on road safety, in reality at some point in time a judgement must be made, as governments cannot spend 50% of GDP on transportation safety (see Stiglitz, 2000, Ch. 11).