INNOVATIONS FOR
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A NEW APPROACH TO MANAGING AT THE CENTER OF GOVERNMENT: GOVERNOR MITCH DANIELS AND INDIANA, 2005–2012

SYNOPSIS

When Indiana governor Mitch Daniels took office in January 2005, he sought to change the performance and culture of state government. The state's economy was stagnant, and the accumulated budget deficit was topping $600 million on a total budget of $22.7 billion for 2003–05. (The state legislature passed a new budget every other year.) State agencies received funding without having to show results, and when funds were available, state workers received pay raises in some years regardless of performance. Daniels recognized that the delivery of bold reforms, including the promise to close the deficit and improve economic growth, required changing the way state government worked. A former corporate executive, Daniels had served as director of the Office of Management and Budget, which, among other responsibilities, helps the US government's executive branch prepare its version of the federal budget, but he had never held elected office. To implement his agenda, Daniels needed new systems and new processes in his office, the center of Indiana state government. He created an Indiana office of management and budget and established a new group within that office to set goals, monitor performance, and link budgets to outcomes. Policy teams in Daniels's office reported progress on agency-level reforms and helped unclog bottlenecks. And Daniels created a performance-based pay system to encourage state workers to focus on results. Daniels's reforms were not without controversy. For example, he scrapped state workers' rights to collective bargaining, and he privatized services previously delivered by government, which led to employee layoffs. By 2012, the final year of his second term, Daniels's reforms had produced marked changes, including a budget surplus every year from 2006 to 2012, and he won praise from both his own Republican Party and opposition Democrats.

Michael Scharff drafted this case study based on interviews conducted in Indianapolis, Indiana in July 2012. Rick Messick provided guidance, editorial suggestions, and interview support. Case published November 2012. Case revised and republished February 2013.

INTRODUCTION

Mitch Daniels had little time to savor the news that he had just won the governor's race in Indiana. It was November 2004, and Daniels, the first Republican elected to the post in 16 years, had less than eight weeks to finalize a reform strategy he had crafted during the campaign before taking the oath of office.

During the campaign, the 55-year-old Daniels had pledged to close a growing budget deficit and improve the performance of state government, with a focus on both agency programs and people.

"The economy was stagnant . . . the state was fiscally broke," said Daniels, recalling the issues he confronted. In 2005, Indiana had not balanced its budget in seven years. The state had accumulated a $600-million budget deficit, which was projected to grow to $800 million in two years. The state's pension funds, including the $11-billion public employee pension fund, which covered more than 200,000 employees and retirees, were severely underfunded. And the 74 state departments, agencies, commissions, and boards—embracing 35,000 employees—operated as separate fiefdoms. Each entity had its own human resources (HR) unit and procurement offices and even information technology, accounting, and voice mail systems. Departments rarely coordinated with one another, and their employees were neither rewarded for good work nor held accountable for poor work. As a result, many public services were delivered with little regard for efficiency or effectiveness.

A 2005 report by the Pew Center on the States, a nonpartisan research group, gave Indiana a grade of C+ on management quality, slightly below average among the 50 US states.[1] Only five states finished with lower scores. Poor management practices sometimes bred uncertainty about expectations, and state departments often lacked transparent accounting practices and financial oversight.

The Bureau of Motor Vehicles (BMV) was a stark example of those problems. At some branches, employees stored cash in desk drawers rather than in safes. The BMV had not since 1985 updated its employee handbook setting out policies and procedures, and few workers had job descriptions. At the BMV, wait times for obtaining a driver's license often stretched for

hours, more than the usual waiting period at motor vehicle offices elsewhere in the United States.

Turning campaign promises into measurable gain would not be easy. "If there is one constant in the histories written about the state of Indiana or in analyses of the culture of the state, it is that we are a conservative state . . . in the sense of resistance to change and slowness to change and reverence for tradition. We like it the way it is," Daniels said. "Our whole reason for running, if I had to reduce it to one sentence . . . was to try to challenge and perhaps change that predisposition to suit a world in which, as I always said, those who tread water sink."

THE CHALLENGE

Although Daniels had never held elected office before becoming governor, his experience in Washington, DC, and in the private sector had helped him understand the scope of the challenges he faced. Early in his career, Daniels was heavily involved in Republican Party politics. He served as chief of staff to Indiana Senator Richard Lugar and chief political adviser to President Ronald Reagan. He later became an executive at pharmaceutical giant Eli Lilly, which had its headquarters in Indiana. Before running for governor, he was director of the Office of Management and Budget in the George W. Bush White House.

As he prepared a strategy, Daniels realized he would have to change the way the governor's office operated. "Government here was a bunch of silos that didn't work together at all and didn't think of a common goal," said Betsy Burdick, who served as the governor's director of cabinet and agency affairs and later as his deputy chief of staff. For example, the eight agencies that issued debt operated independently of one another, which meant, for example, that they issued debt in inconsistent ways. To make matters worse, Daniels struggled to stay informed about activities

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in the state's 74 departments, agencies, boards, and commissions. Communication and reconciliation requirements threatened to exhaust the governor's time.

First, the state's fiscal problems had arisen partly from the absence of a central financial office to harmonize the work of the many offices that shared responsibility for different parts of the budget process. Responsibility for budget processes lay with several, separate units, including the State Budget Agency, the Department of Revenue, and the Department of Local Government and Finance. The same Pew report that had given Indiana a C+ on overall quality had assigned the state an even lower grade, a C, on money management.

Second, Daniels wanted to improve efficiency and effectiveness in government service delivery as a way to reduce the deficit and make taxpayer dollars go further. However, no system or institution existed that could work with the governor and the departments to create a set of priorities and come to agreement on ways to measure progress toward reaching goals. A dearth of metrics and data on agency outputs meant that decision makers could not allocate funds based on performance. "Lack of quality data was issue number one," said Adam Horst, who would later play an important role in developing a results-based system.

Third, improving efficiency meant changing the workplace and finding new ways to motivate employees; yet the Indiana state government Daniels was now running had received a C on personnel management in the Pew report. Responsibility for developing and administering human resources policies that were clear and that applied to all employee levels fell to the State Personnel Department. But each agency had its own human resources staff, many of whom neither communicated with nor reported to the personnel department; and such fragmentation

hindered efforts to enforce uniform standards. "If you look at what each agency was prior to 2005, each agency would have its own HR staff, benefits person, recruiter, talent acquisition person, [and] employee relations person adjudicating state employee claims," said Denny Darrow, a senior official at the State Personnel Department. "So not only did we have a redundancy of effort; we also had very inconsistent delivery of outcomes, advice, [and] adjudication of different processes. . . . A uniform, centralized form of HR delivery was paramount to being consistent and delivering a good performance management tool."

As inauguration day approached, Daniels knew he had to move fast. "It made great sense to strike while the iron was hottest," he said. He recalled telling his staff that "the honeymoon will end on the first day of change." His party, the Republicans, held a majority in the bicameral General Assembly, but Daniels knew the party's control was shaky. (Within a year, by November 2006, Republicans would lose their majority in the House.) Daniels said: "As a general principle, we assumed we should do as much as we could—as fast as we could. We always viewed, to use another cliché, political capital as renewable. Capital, properly invested, earns a return, which you can then invest in the next change and the next one." The clock was ticking.

FRAMING A RESPONSE

During the transition period, before taking office, Daniels had to think about how best to address the coordination problems while also getting his administration up and running.

The governor-elect moved first to establish a transition team and identify the people who could help carry out his agenda. As in most US states, the governor had the authority to appoint the heads of most departments and the staff in the executive office. Indiana governors had also appointed most of the more than 2,400 people

who served on state boards and commissions.

Daniels drew heavily from the contacts he had cultivated during his years in government and the private sector. Many of the same people who had held roles in his election campaign, including advisers Harry Gonso and Neil Pickett, assumed senior positions on the transition team and later in the Daniels administration. Gonso, an Indiana-based attorney, headed the transition team and later became chief of staff. Pickett, who held a master's degree from Oxford University and had developed corporate strategy at Eli Lilly, continued giving policy advice to the transition team and later to the administration.

The governor-elect's approach to hiring was first to get people to commit to serve in government before determining which candidates were best suited to particular departments. Tapping his contacts, Daniels personally extended many invitations. Earl Goode, retired president of telecommunications firm GTE Information Services, was one of those he contacted. "He was looking for talent based on his vision of what he wanted to accomplish as governor of Indiana," said Goode, who initially served as commissioner of the Department of Administration and later, in November 2006, became Daniels's chief of staff. Daniels recalled that his pitch to Goode and others sounded something like, "Darn it. You've been complaining about these things for a long time. This is your chance."

Daniels's personal charisma helped attract talent. Pickett said, "It was really an extraordinary group of people from a wide range of backgrounds who all sort of rallied to the flag and wanted to serve and were enthusiastic about serving because they believed in him."

A staffing committee recruited agency heads and people for other roles in the administration. Gonso took the lead in interviewing applicants in a conference room at the back of the transition office.

While the process of identifying top staff members continued, Pickett's transition team had to learn the inner workings of government before team members could weigh options and develop an informed strategy for quickly executing reforms. Outgoing governor Joe Kernan, a Democrat, permitted Daniels's team to pore over documents and talk to staff in the governor's office and at the agencies. Pickett gathered transition team members for the exploratory mission, divided the staff into groups, and assigned each group a set of agencies. "Some of them [the team members] had pretty obvious backgrounds in connecting to agencies," said Pickett, referring to the team members' familiarity with the agencies they were assigned to. "Some of them were just smart." Pickett said the Kernan administration's help was an important factor. "They were quite cooperative for the most part and didn't make it hard for those teams," he said.

The teams sought to learn organizational details like the number of state employees at each agency. Teams also tried to assess how decisions were made, such as how the State Budget Agency allocated agency funds. Finally, the teams examined existing management structures, like the reporting lines between agency heads and the governor's office.

As they worked, team members found problems that helped deepen their understanding of the challenges the state faced. For example, they discovered that the Indiana Department of Commerce (later renamed the Indiana Economic Development Corporation) had no strategy document to guide the department's work, and its own managers were not aware of their department's goals. The Department of Administration held the ownership certificates for 160 vehicles but could not account for the vehicles' whereabouts. The Indiana Department of Transportation, which managed the Interstate

toll road, had not increased tolls in 20 years. Some tolls were as low as 15 cents and the state estimated that it cost 34 cents on average to collect each toll. And at the Bureau of Motor Vehicles, there were long delays and many opportunities for corruption. Any BMV employee, including the lowest-paid workers, had the authority to remove violations, delete points, and clear suspensions from customers' computerized driving records.

When Pickett's teams reported in, the governor assessed options for addressing the three major challenges he had identified—financial management, service delivery, and personnel—all of which had at least some roots in poor coordination. He decided to create the Indiana Office of Management and Budget (OMB), including a unit within the OMB to measure agency performance and to link budgeting to outcomes. He modeled the agency performance unit on a similar innovation he had piloted when he was OMB director at the federal level. Further, Daniels established policy teams in his office to complement the work of the OMB unit by keeping tabs on day-to-day operations at agencies and by helping clear bottlenecks. Third, he planned to introduce a pay-for-performance system.

Daniels also sought a few areas where he could score some quick wins. "There was an even higher premium, I thought, on successful, bold, visible action that would announce to our fellow citizens that A, these people really meant what they said when they were campaigning, and B, there is a new day here," Daniels said.

GETTING DOWN TO WORK

On his first day in office, Daniels sent a letter to state employees, thanking them for their work and noting that change was imminent. "I'm privileged, starting today, to be able to call you my colleague and coworker," Daniels wrote. "We have meant what we said over and over: We believe in you. We assume that you are in the public service for the right reasons, that you want to work hard and 'work smart' to make life better for every Hoosier [a nickname for Indiana residents]." He then signaled a shift in policy: "Please understand: things are going to be different. From now on, Indiana state government will be about results. We will ask of every department, What are our goals here? What will we measure to determine whether we are achieving them or not and whether we are steadily getting better at it?"

Performance budgeting

Daniels knew that leaders often failed to articulate the clear vision managers needed so they could set targets that advanced government priorities. He recognized that leaders sometimes disregarded data when making important decisions. The new administration would have to think carefully when designing a system to link priorities, budgets, and performance.

"Having a very empowered budget office was important," Daniels said. "There was always a budget office, but we wanted to really add to that." On his first day in office, Daniels issued an executive order creating an Office of Management and Budget, which was designed to orient all fiscal agencies toward the same goals. The new head of the OMB had cabinet-level status, and the new office was a direct challenge to the way Indiana's agencies had traditionally operated in silos. The reorganization did not eliminate any of the existing fiscal agencies, departments, or authorities but instead shifted all of the groups to command by the OMB. The groups were the Department of Revenue, Department of Local Government Finance, Indiana Finance Authority, State Board of Accounts, State Budget Agency, and Indiana Public Retirement System.

Within the OMB, Daniels established a new, five-person group called the Government Efficiency and Financial Planning Unit. He appointed Cris Johnston, then a partner at a

public accounting and consulting firm, to head the group. The unit would work with the governor to establish goals for each department and to develop a system for monitoring progress.

"We viewed [the unit's] job as, How do we measure programs [and] how do we measure services delivered to Hoosiers?" said Horst. The efficiency unit used the results to decide the amount of funding to direct to each agency program.

The 2005–07 budget bill, drafted under a Republican majority in both the state House and Senate, reinforced the new unit's mission. The bill instructed the OMB to review the budget and function of each executive department agency so as to find inefficiencies that could be corrected to save money.

To begin the review process, the efficiency unit designed an 18-question template focused on three fundamental concepts: Is the program purpose clear? Does it address a specific or existing problem? Is it redundant or duplicative of other state, local, or private efforts? "We forced ourselves to a yes and no, not a lot of gray or maybes," said Johnston. The efficiency unit director assigned each member of his team the responsibility for examining specific departments and programs grouped by functional themes like public safety and health and human services.

In January 2006, the unit published its preliminary findings, and Daniels gathered his department heads and other top administration officials to review the results. The meeting was a chance for Daniels to reiterate the tone his administration would set to tackle collectively the challenges ahead. Johnston presented the findings.

The report noted that only 38% of departments collected data on their operations and impact, and therefore a baseline measure of performance did not exist. The report also found that the siloed program management within each agency created overlap and duplication. For example, the Indiana Horse Racing Commission had both a Standardbred Advisory *Board*, which advised the commission on horse-racing issues that involved gambling, and a Standardbred Advisory *Committee*, which provided the commission with guidance on nongambling forms of horse racing, such as racing at county fairs. The report recommended consolidation of the board and the committee.

Moreover, the study found a lack of financial and management oversight within individual departments. A case in point was the Department of Veterans' Affairs, which for years had funded the operation of the Indiana Veterans Memorial Cemetery from the department's main operating account despite the fact that the legislature had created a Veterans' Cemetery Fund for the explicit purpose of paying for the cemetery's operation. In 2005, the cemetery fund had an unused balance of $2.5 million.

Horst recalled that the report's findings affronted those in charge at some of the agencies. But, said Horst, "We called it like we saw it."

Following presentation of the preliminary findings in January 2006, the efficiency unit continued its review of programs. By the spring of 2007, after spending 15 months reviewing 420 programs, Johnston's team began the process of setting program targets. One at a time, agency heads were invited to a meeting with an OMB analyst whose portfolio included the agency in question. Someone from the governor's policy shop also joined the session. They looked at the broad goals that had emerged from review of the questionnaires administered earlier and what they could glean about existing performance levels from the scant data available. In some cases, they looked to the ways similar departments in other states like Virginia—which posted performance measures—set targets and evaluated progress.

The starting point for the conversation was often the particular department's mission statement, which itself sometimes needed updating but tended to offer a macrolevel view of

the department's purpose and vision. From the mission statement, the meeting participants devised a list of goals that were important to the department. "With the BMV, it was very clear that reducing wait times and improving customer satisfaction were going to be on the list," said Horst.

But agreeing on targets often was difficult. Agency personnel complained they were not always in control of outcomes. For example, the state police protested its target for reducing traffic fatalities, citing unpredictable factors like weather. If disagreement arose over the question of control, the OMB staff would try to ascertain whether the agency influenced the outcome. "They had one of two roads to go down when responding," said Horst. "If they said no, then we suggested we stop funding it completely. If they said they had some influence over it, then we told them we realized the outcome indicator was not a conclusive statement. The next question was, Were there other factors at play?" While the efficiency unit described the target-setting conversations as collaborative affairs between the unit and department heads, ultimately it was Johnston and his team that made the final decisions.

Johnston's team tracked progress for each agency on a spreadsheet. The left-side column on the spreadsheet listed targets, and each corresponding output appeared in one of three color-coded columns based on level of achievement. The colors—green (achieved), yellow (partially achieved), and red (not achieved)—helped the efficiency unit quickly assess progress. The tracking system also enabled the governor, who met with his agency heads on a regular basis, to stay abreast of performance.

Departments reported results quarterly, and about once a year, the efficiency unit would meet with department heads to discuss whether to revise targets or add new ones. Daniels pushed his people to keep raising their targets. "People would be so proud," said Horst. "They would reach their

target and think the governor was going to pat their back." Instead, Horst said, "he'd say, 'OK, we're going to raise the bar.' People would say, 'Where's my acknowledgment?' And he'd say, 'Good enough never is. What's our next thing we want to achieve?'"

Department results served as important guides during the budget process. At key moments in the budget cycle, the results factored into funding decisions. For instance, early in the budget cycle, agencies submitted their individual budget requests to the State Budget Agency, which in turn reviewed the requests and proposed changes if needed. Also, the governor had allotment authority, meaning that Daniels's office could decide how to implement the budget after the legislature approved it. "I think the information they had from the efficiency unit allowed them to use their allotment authority more effectively," said John Ketzenberger, president of the nonpartisan Indiana Fiscal Policy Institute. But making informed budgeting decisions on things like which particular programs to support at a department sometimes required data that had not been collected.

"Early on, it was quite difficult because of either the lack of data or the lack of a good historical data set from which to draw many conclusions," Horst recalled. He said that when it came time to decide how much to fund each department, an important consideration was "how well the department embraced the idea of measuring agency performance." The unit gauged the department's openness to being measured by factors like the speed with which a department submitted its quarterly results or whether the department demonstrated persistence and dedication in attempting to improve its performance.

"Agencies would come in and ask for funding for programs," said Horst. "Over time, they got the message that if they couldn't show they were effective and efficient and measuring, we would be

less inclined to fund them." Critically, Horst stressed that when it came time to make funding decisions based on performance, "we tried to use the outcome indicators as the start of a discussion, not as a conclusion."

Streamlining monitoring and reporting

Daniels's quest for efficiency extended to his own office, where he sought to stay abreast of the work of the state's agencies and departments in ways that fit comfortably into his busy schedule.

Cabinet meetings provided Daniels with an opportunity to keep people focused on his vision of realizing greater economic improvement in the state. Burdick, who was Daniels's director of cabinet and agency affairs in 2005, recalled that the cabinet met monthly in the early part of the governor's tenure, though in later years the cabinet met at most four times annually. "Early on, they [the cabinet meetings] were very important because it continued to impress upon everyone that this is our single goal," Burdick said.

Daniels's cabinet consisted of 17 people, including the governor and lieutenant governor—the only two elected posts. Everyone else in the cabinet was an appointee, and most were department heads. Daniels used the seating arrangements—he would place his head of economic development in the seat next to him—to stress the importance of various issues on his priority list. (Daniels created the Economic Development Corporation, a public private partnership to grow existing businesses in Indiana and attract new businesses to the state.) Cabinet meetings were also important to promote collaboration between departments and ensure cooperation among department heads.

While the monthly cabinet meetings offered a chance to check on progress toward the governor's major goals, policy analysts in the governor's office ensured on a daily basis that departments were implementing policies toward those goals. Pickett was head of the governor's

policy shop, and six analysts reported to him. Pickett assigned each analyst a set of agencies to support, paralleling the approach Johnston used in his efficiency unit. An analyst's job was to keep abreast of developments and to submit summaries, once every two weeks, of milestones achieved, policy issues arising, and other matters. The reports often pointed to major accomplishments and highlighted potential problems.

Pickett condensed the analysts' reports into a single briefing paper for Daniels. "The governor would go home and write all over them," said Burdick, who later assumed Pickett's role when Pickett returned to the private sector. The deputy chief of staff recalled that the marked-up copy she received usually included requests for more information or instructions to arrange a meeting with relevant agency personnel.

To signal to his agency leaders the importance he attached to analysts' roles, Daniels made sure to include the analyst whenever he met the agency head, which he tried to do as often as possible. The relationship between most agency heads and analysts was marked by respect and cooperation. "Some agency heads found them [the policy directors] tremendously useful and understood how to use them as that pathway into the governor's office," Pickett said.

Agency heads didn't always get along well with their assigned analysts—sometimes because of gaps in age and experience. "When you have a 20-something-year-old trying to hold [to account] a former CEO who is an agency head, it takes a little time" to develop the relationship, Burdick said. Another common source of discord lay in many agency heads' prior relationships with Daniels from the private sector, some of whom seemed to feel they could bypass the policy person and take matters directly to the governor.

Burdick and Pickett intervened when relationships became strained, and they attempted to pinpoint the reasons for disagreements and to mediate disputes. When repeated mediation

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efforts failed, Burdick asked the agency head and policy person to meet with the governor, who gave clear instructions to both sides to work together.

Promoting efficiency and effectiveness

The governor said that one way to reduce spending was to outsource government services to private companies that could deliver the services more cost-effectively and with greater efficiency. By privatizing services, Daniels's administration would be forced to cut jobs; and the unions, which represented public employees in the state, would undoubtedly put up resistance.

Despite the potential for blowback, Daniels issued an executive order on his first day in office, ending collective bargaining between the unions and the state's roughly 16,000 dues-paying public employees. The unions remained, but they had reduced powers; and state employees who thought the unions played no useful role could opt out of paying membership dues. The administration would still have to adhere to existing civil service procedures when laying people off, but the absence of the employee unions from the decision-making process would give Daniels far greater flexibility in deciding which programs to privatize and, therefore, which employees to cut from the government's payroll.

"I was not surprised that getting rid of collective bargaining was one of the first things Governor Daniels did," said Brian A. Howey, a longtime observer of Indiana politics and publisher of a nonpartisan newsletter on Indiana state politics. "Daniels saw getting rid of collective bargaining as the quickest path to rectifying what he saw as a major budgetary problem." Howey said he was surprised, however, at the lack of protest against the governor's executive order. Within a few months, roughly 90% of public employees chose not to opt back into the unions.

Certainly, the lack of outcry was curious when compared with attempts by other US

governors to rescind collective bargaining rights—notably, Wisconsin governor Scott Walker's attempt in 2011, which met strong resistance from state workers and public employee unions.

The lack of strong protest likely had three roots. There were important differences between the Indiana and Wisconsin examples. For one, Daniels acted unilaterally, while Walker's proposal required legislative approval. Plus, in Indiana, only state workers were affected, while in Wisconsin most state *and local* employees, including teachers and municipal workers, lost their right to collective bargaining. Howey remarked it was likely that the lack of protest was also tied to a sentiment among employees that the unions were doing little to help them. For most of the short period that collective bargaining had existed (it was introduced in 1989), state employee pay was almost static. Former Democratic governor Evan Bayh had frozen salaries at one point. Howey observed, "I can see if public employees didn't feel like they were getting a lot of bang for their buck."

Privatization did lead to layoffs. However, employee attrition, especially retirements, was the main reason for the reduction in the total size of the state payroll. Daniels's campaign promise to create a performance management system may have encouraged some employees in late 2004 and early 2005—in particular, workers who were older and whose retirement accounts were fully vested—to leave rather than face the uncertainty and challenge of dealing with changes in their workplaces. In 2004, 301 employees retired voluntarily; the number of retirees had more than doubled by 2007 (761 retirements) and more than tripled by 2009 (957 retirements).

Anita Samuel, Daniels's policy director at the State Personnel Department in 2005, who later became the governor's general counsel, said the department tried to ease the impact of force reductions by helping laid-off people obtain other jobs in state government. And civil service laws

required that hiring managers give special consideration to candidates who were applying after layoffs resulting from the reorganization.

Evaluating and rewarding employee performance

Rewarding state employees for good performance ranked high on Daniels's agenda. "I think in general, public employees get a bad rap," he said. "Most of them want to do a good job. Too many of them are in settings that don't challenge them and certainly don't reward them for doing a good job." In years in which funds were available, personnel offices had given salary increases regardless of performance.

Daniels wanted to be able to exercise the power of the purse to reward employees based on their performance. Under Daniels's predecessors, any attempts to change the compensation structure, like tying employee pay to performance, would inevitably have involved lengthy negotiations with the public employee unions. Daniels feared that unions would slow the pace of change and make it hard for Hoosiers to see results fast, although in principle, he could have negotiated to restrict bargaining to wage issues. Union supporters argued that the unions were vital to advocating for workers' rights on things like salaries and benefits and that without a strong advocate, employees could be susceptible to all types of abuse by senior managers and elected officials. Union detractors, however, claimed that unions shielded underperforming employees from scrutiny and allowed those workers to remain in their jobs—to the detriment of taxpayers. Daniels's decision to end collective bargaining helped pave the way for the changes.

To determine who should receive raises and at what levels, the governor needed a way to measure each state employee's performance. Two of the challenges Daniels initially faced were (1) the absence of management standards that applied to all departments and (2) a lack of clear reporting

lines between department-level human resources offices and the personnel department.

Stronger coordination and direction were critical to the success of a performance evaluation system. When Daniels took office, departments each had their own human resources directors. Under Daniels's watch, the heads of the department-level human resources offices became employees of the State Personnel Department. Although those office heads physically remained in their respective departments, their new status as employees of the government-wide operation meant that they now reported directly to the people overseeing implementation of the performance management system. Darrow, who helped manage the personnel department, said the move cleared the way for fast, effective propagation of Daniels's ideas and goals across many levels of government, facilitated consistent application of unified policies and procedures, and led to accurate monitoring of implementation.

The State Personnel Department took the lead in designing the new performance system. "We had very clear mandates from the beginning," recalled Darrow. "Our desired outcomes were: Let's weed out and manage poor performers, have managers be more accountable in the process of managing their employees—setting up goals that are realistic, timely, and measurable—and most of all, reward and retain our top performers."

Darrow and Samuel assembled an eight-person project team. The team looked at how the private sector handled employee evaluations and merit pay and decided that Indiana's system should be as simple and direct as possible. "It couldn't be something that was complicated with multiple measures and weightings," said Samuel. "We had to be able to directly tie work performance to outcomes, and those outcomes had to tie back to agency performance."

Under the leadership of its new head, J. David Donahue, the Indiana Department of

Correction was one of the first agencies to define its mission and set new goals. As a result, the department became a logical place to test the new performance management tool. In August 2005, the personnel department assembled focus groups of correction department managers and employees. Darrow and his colleagues explained how the system would work, and they showed the standardized form they had designed for managers to use in evaluating employees. Personnel staff took note of what the participants found useful and clear and what they found unhelpful or confusing.

The personnel department announced the specifics of the plan in a December 2005 e-mail to all state employees. Darrow's team then met with all of the agency heads, program directors, and managers to explain the system. Workers would set targets in individual meetings with their managers. A standardized evaluation form gave managers three options on which to rate performance on each target: met expectations, exceeded expectations, or did not meet expectations. (In 2009, the personnel department added two more categories—needs improvement and outstanding—to give managers more options.) The first target-setting conversations between managers and employees occurred in mid-2006. Following the initial session, employees met yearly with their managers to review performance and, if necessary, reset targets.

Depending on an employee's final evaluation score, a manager would recommend a pay raise of 0%, 4%, or 10%. Under the old system, the average pay raise had been 2 or 3% a year. "We really wanted to set an incentive for folks to be in a high-performance category," said Samuel, referring to the 10% level. "We wanted those high performers to see that this really is a benefit to them." Daniels had the authority to set the pay targets as long as he did so in consultation with the personnel department. The levels changed on a yearly basis.

For both practicality and affordability, Daniels's team knew that managers had to use keen discretion in awarding the top, 10% pay increase. The State Budget Agency modeled a bell curve whereby only a certain percentage of employees could receive 10% raises. The curve was designed so that the total salary increase stayed within budget projections. In 2006 and 2007, the percentages of state employees designated to receive the 10% increase were 7.7% and 7.0%, respectively. (In those years, approximately 85% met their performance goals, and approximately 7% did not meet expectations.) In 2008 through 2011—when the number of categories went from three to five—approximately 3% did not meet expectations, approximately 4% needed improvement, approximately 79% met expectations, approximately 12% of employees exceeded expectations, and less than 2% of employees received the highest categorization: outstanding.

The legislature also appropriated a personnel contingency fund, which the governor's office had the authority to draw on to make up any shortfall in salaries. Daniels's office drew on the fund to make up for the deficit created by the magnitude 10% increase.

The personnel department monitored the aggregate performance ratings at each department. If a department manager's evaluations, which the manager submitted to the personnel department, did not adhere to the curve, the department would ask the manager to reevaluate his or her team. Nonperforming employees who failed to receive pay raises were subject to what Darrow called a work improvement program. Such employees had 60 days to improve their performance, after which they were reevaluated by their managers. The personnel department then had the legal authority to fire those who failed to make progress.

An employee grievance board at the personnel department adjudicated employee claims of discrimination or other improprieties of

the evaluation process. Although the department did not have a specific definition of discrimination, complaints involved gender, ethnicity, or sexual orientation. Of the several hundred cases brought each year, 99% were initially accepted, and about 5% would be dismissed for such reasons as failure to appear or failure to prosecute. After civil service legislation was passed in 2011, the department also accepted complaints related to that system (31 in 2011 and an estimated 130 by the end of 2012). Because those cases required more judicial resources and were more complex, only about half were accepted as to jurisdiction in 2011 and 2012.

OVERCOMING OBSTACLES

The global recession that began in 2008 forced state and local governments throughout the United States to scale back their spending. Daniels, whose administration had worked to cut costs from the beginning, sought to reduce spending even further rather than risk a budget deficit. He froze all state salaries indefinitely, including his own. "What I hated about that was that I wanted to deeply embed this notion that we pay for performance in Indiana," said Daniels, whose pay-for-performance system had existed for only two years when he decided to freeze pay levels. While no employees saw their paychecks reduced, Daniels's decision risked angering workers and threatened to halt the momentum of one of his signature reforms.

The Governor's Public Service Achievement Awards may have helped maintain employee morale, though there are no polls or surveys to suggest that the awards had any noticeable effect on employee attitudes. Managers could nominate their subordinates for the awards, which recognized individual workers and project teams that discovered cost-cutting measures that also improved service delivery.

Once a year, Daniels held a ceremony at his office to acknowledge award recipients.

Winners included an employee of the office of the adjutant general who had developed an automated system to pay active-duty members of the Indiana National Guard by direct deposit. The system not only was a matter of convenience for guard personnel but also eliminated written forms, thereby reducing costs. Daniels gave another award to a Department of Transportation team that discovered that paving crews could increase the maximum percentage of recycled asphalt pavement in hot-mix asphalt. One year after changing its asphalt mix, the state had saved $10 million.

In December 2011, with the global economy recovering slowly and Indiana's finances improving, Daniels restored pay raises—though not to the levels employees had once received. State workers could now earn raises of 2%, 4%, and 6% based on their performance evaluations. Also in 2011, to thank employees for their patience during the period that salaries remained stagnant, Daniels declared an "efficiency dividend" and—dipping into the extra funds generated by the budget surplus—gave every state employee a $1,000 bonus.

ASSESSING RESULTS

Daniels won office promising to restore the state's fiscal health and make government work better. His first budget (fiscal year 2005–07) was balanced and achieved surpluses in both years.[2] The 2007–09 budget was also balanced and returned a surplus in 2008, the same year that credit rating agency Standard & Poor's gave Indiana its first AAA bond rating, citing Indiana's fiscal management.[3] However, in fiscal year 2009, with the global recession in full force, revenue fell short of projections, and the state ended the year with a budget deficit. The 2009–11 budget cut funding across most agencies on an average of 8 to 10 percent.[4] Despite the cutbacks in spending, the state ran deficits in fiscal years 2009 and 2010.[5] To avoid further shortfalls, the fiscal year 2011–13

budget enacted additional deep spending cuts across an array of programs, including to K-12 education.[6] The spending cuts, combined with an improving economy which helped drive up tax revenue, contributed to budget surpluses in fiscal years 2011 and 2012.

Daniels registered an approval rating of 63% in April 2012, according to a bipartisan poll conducted by Democratic pollster Fred Yang and Republican pollster Christine Matthews. The Pew Center on the States called Indiana the "most improved state in the country" and gave the state a rating of very good in its 2008 report, an improvement from the average rating it had given Indiana three years earlier. The report examined four categories—money, people, infrastructure, and information—each with five different outcomes. Each outcome was rated as either a "strength, midlevel, [or] weakness." Indiana received a "strength" rating on outcomes like financial controls and reporting, managing employee performance, and internal coordination. The state scored "midlevel" ratings on outcomes like retaining employees and contracting and purchasing. The only outcome rated as a "weakness" was the state's handling of performance auditing and evaluation, which fell under Pew's information category. The Pew reported noted that part of the reason for the low ranking was the absence of "an independent audit agency with a performance audit function."[7] (The 2008 report was the last report published as part of the center's 14-year grading project.)

Having policies and processes in the governor's office to guide and manage a reform agenda represented a major part of the story of how Daniels was able to get things done. For example, the efficiency unit measured department performance, which helped the administration decide where to steer funding. Daniels's policy teams streamlined reporting functions. No longer were individual agency heads knocking on the governor's door every time they had a question or

every time troubles arose. The briefing paper gave the governor the information he needed to keep track of important developments and trends. Yet by meeting regularly with department leaders, Daniels avoided creating an extra layer of bureaucracy.

Daniels's management style played an important role in his success as governor. At the start of his first term, Daniels put a premium on hiring talent, and in later years he tried to identify new employees by asking his colleagues to suggest successors, even though no change in personnel was imminent. He built a list of good potential hires in this way. Further, Daniels' implementation of the performance management system demonstrated his unwavering focus on results. On his first day in office, Daniels issued a letter to all state employees giving them notice that a new performance management system was coming. And then he stuck with the reform, meeting annually with his department heads to review their performance and deciding on the percentage increases in public workers' salaries.

The average state employee's salary rose 16.4% from 2005 to 2012. Nearly 91% of roughly 10,000 state workers who responded to a 2011 personnel department survey said they clearly understood the mission and goals of their individual agencies. Approximately 79% said that they understood the competencies and skills required of them. (In the absence of earlier surveys, no comparison data existed.) Darrow noted that the number of cases sent to the employee grievance board was "fewer and fewer every year." For instance, the number of [Merit Act] cases declined to 157 in 2011 from 410 in 2005. (However, new cases arising from the 2011 civil service legislation were on the rise.)

On his first day in office, Daniels showed his penchant for risk taking by rescinding state workers' power of collective bargaining. His executive order could have encountered opposition that might have cast a shadow over other reform

efforts. Instead, it gave him the flexibility to move swiftly in consolidating and privatizing government services, which led to cost savings and contributed to the state's improved economic outlook.

Daniels' focus yielded tangible results. Some of the agencies that the administration's policy teams had early on determined were the worst performing, like the Bureau of Motor Vehicles, registered improvements. By 2008, a customer's average wait time was 8 minutes and 36 seconds, down from roughly 40 minutes in 2005, and the combined wait and processing time appeared on the customers' receipt. In 2012, the bureau won its third International Customer Service Award in five years from the American Association of Motor Vehicle Administrators.

Other agency turnaround stories told of less success. In 2005, when the Annie E. Casey Foundation, an established private foundation that advocates for disadvantaged children, published its annual rankings on the well-being of children, Indiana appeared at or near the bottom of every category of child services among the 50 states. In an effort to improve child welfare assistance, Daniels created a new Department of Child Services, which merged functions previously controlled by an unwieldy Family and Social Services Administration. Each county was administering its own child welfare services, and in creating the new department, Daniels folded 92 different county programs into one. Caseloads were cut in half, and more children made monthly contact with caseworkers. Problems remained in 2012, however, including a higher-than-average rate of removing children from their homes, which went against the advice of child care experts who suggested that in most cases, children raised in the home were ultimately better off than children who lived in foster homes.

REFLECTIONS

Speaking at his office in 2012, Indiana governor Mitch Daniels noted that the speed with which he moved to enact his reform agenda following his initial election in 2004 was a critical component of his success. He recalled receiving a visit from a group of governors who had been elected in 2010 and were seeking his advice on governing. "I urged them that if they had big things to do, to go hard and go early," he said.

But being able to enact a reform agenda hinged on more than timing and speed. Daniels, named to become president of Purdue University at the conclusion of his term in January 2013, said that taking control over state finances and making government work better required a combination of factors: "Some clarity of purpose, some degree of real empowerment, some degree of accountability, more tools—meaning the ability to reward the best and promote the best and vice versa, [and] gathering the reins where that's appropriate centrally."

One of the tools with which Daniels drove his focus on efficiency while promoting accountability as a means to smarter budgeting was his Government Efficiency and Financial Planning Unit in the Office of Management and Budget. "There may be other leaders like Mitch—but I don't know them—who understand the interplay between the budget and policy ideas," said Adam Horst, whom Daniels named in 2005 as a member of the new efficiency unit and who in 2012 directed the Office of Management and Budget. "He understands the management. He knows where he wants to go, and from day one, that makes your job a lot easier."

Mark Lubbers, a senior adviser in Daniels's campaign and in the administration, recalled that the governor's focus on enhancing the performance of state government was ultimately

about changing expectations. "We believed strongly that culture was an impediment to success," he said, "and that it required changing if Indiana were ever to move ahead at somewhere near the pace of change in the world."

But bringing about a cultural change would not happen overnight. Referring to the pay-for-performance program, Denny Darrow of the personnel department said that changing the culture takes several years and requires "the behavioral mind-set to shift among the employees to be effective. . . . You have to enter into these

types of processes knowing it's not a one-year thing."

Daniels conceded in 2012 that he was worried that the culture of change and efficiency could easily be undone, but he was confident his reforms had shown citizens that a break with the past was possible and state institutions could serve them better. He hoped his efforts would make people less cynical about government. "At least in a setting like ours, big and numerous actions begin to change the expectations," he said.

UPDATE: The first part of the Assessing Results section has been updated to provide additional information on Indiana's budget from 2005–12.

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[1] Government Performance Project, "Grading the States 2005," http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Government_Performance/GPP_Report_2005.pdf.
[2] Indiana State Budget Agency, "Report on Appropriations 2005," http://www.in.gov/sba/files/ap_2005_0_0_4_letter_only.pdf.
[3] Indiana State Budget Agency, "Report on Appropriations 2007," http://www.in.gov/sba/files/ap_2007_0_0_4_letter_only.pdf.
[4] Indiana State Budget Agency, "Report on Appropriations 2009," http://www.in.gov/sba/files/ap_2009_0_0_4_letter_only.pdf.
[5] Indiana Local Government Information Website, *An Overview of the Indiana State Budget*, http://www.agecon.purdue.edu/crd/localgov/topics/essays/State_Budget.htm#Where.
[6] Kristen De Pena, *Indiana Makes Fiscal Progress*, State Budget Solutions, http://www.statebudgetsolutions.org/publications/detail/indiana-makes-fiscal-progress.
[7] Government Performance Project, "Grading the States 2008," http://www.pewstates.org/uploadedFiles/PCS_Assets/2008/Grading-the-States-2008.pdf

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