

Entrepreneurial Thinking in Local Government

How governments can use community assets to uncover potential new revenue

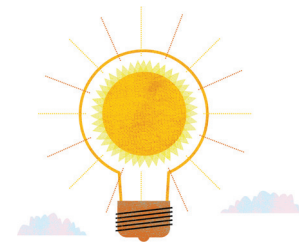
BY SHAYNE KAVANAGH

Most people assume that private enterprise is inherently more dynamic than government. This leads to a belief that local governments can't think creatively and pursue new ventures. This may lead to traditional government services being transferred to the private sector via strategies like privatization, long-term leases of assets to private operators, and outsourcing.

Certainly, private enterprises have many strengths. Also, tools like outsourcing have their time and place. However, this article contends that local governments may have opportunities to raise new revenues and create value for the public by thinking more like a private enterprise. To start, consider that private firms are not always superior to government when it comes to efficiency, innovation, and other characteristics

associated with dynamic organizations. For example, research on outsourcing of public services has shown that what matters to an efficient/effective public service is not merely the publicness or privateness of an organization, but whether the organization providing the service is subject to competition.¹ This suggests that, under the right conditions, governments could be as or even more efficient, innovative, etc., as a private corporation. Therefore, local governments may have opportunities to pursue entrepreneurial activities that take advantage of the assets they have to create more value for the community and financially strengthen the local government.

The Rethinking Revenue initiative has published a paper on Urban Wealth Funds,² which is about maximizing the value of public assets by using competitive management



Innovation, along with efficient execution of the idea to create new value for the public, is what we will refer to as *entrepreneurialism* in local government.

techniques while retaining full public ownership and control. This is one form of entrepreneurialism in local government. Urban Wealth Funds are closely associated with larger metropolitan areas. However,

RETHINKING REVENUE

The **Rethinking Revenue** initiative is a joint project of many organizations that have an enduring interest in creating thriving local communities and making sure that those communities are served by capable and ethical local governments. Rethinking Revenue is about providing local governments with the ability to raise enough revenues for the services their communities need—and to raise those revenues fairly and in a way that is consistent with community values.

entrepreneurial thinking can happen at any scale, from the very small to the largest governments. In this article, we will illustrate entrepreneurial thinking using the City of Lancaster, California. Lancaster has a population of about 150,000. Though it is located in the northern part of Los Angeles County, it is separated from the main population center of the county by a large area of protected forests and mountains.

Entrepreneurial thinking can happen with any public service, but probably the greatest potential is in asset-intensive services. This is because asset-intensive services have the most potential for economies of scale. Economies of scale allow for lower per-unit costs as more units are produced. By thinking entrepreneurially, the City of Lancaster became active in energy production and solar power. As of fiscal year 2020–21, the city's energy operation comprised \$40 million of a total \$234 million city budget. The energy operation more than covers its cost. The fund that accounts for the city's power activities has a fund balance of nearly \$7 million compared to its \$40 million annual revenues. Also, the fund's revenues help offset some of the city's overhead costs, like finance and administration.

Of course, not every local government can be in the power business. Hence, the focus of this article is not municipal power but rather how the city recognized how it could parlay its existing assets (physical or otherwise) to create new revenue for the city and value for the public. Other local governments may find they have similar potential in municipal power or maybe potential in a different service by thinking entrepreneurially. To illustrate, the City of Lancaster is pursuing or considering the following ideas:

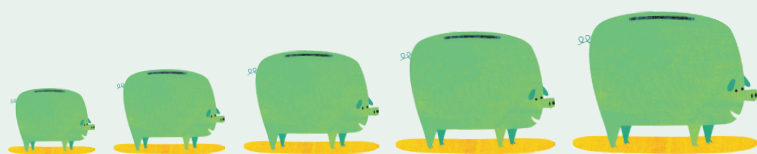
- ➔ Using the city's zoning power to increase the value of vacant parcels owned by the city and capturing the value of those parcels via new development.ⁱⁱ
- ➔ Working with the local broadband internet provider to create municipal "add on" services, like municipal wireless internet.
- ➔ Developing a local industrial park focused on biotech. But instead of building a site and handing it over to private firms, the city keeps a share in the products that are incubated at the site.

Local Government Assets That Can Support Entrepreneurialism

Like many cities, Lancaster operates several asset-intensive services, including recycled water, a storm drain system, and a sanitary sewer collection system. What Lancaster has done differently than other local governments is to think broadly and strategically about its assets and how it might derive value from them. This includes physical assets like infrastructure and land, and other assets like human resources, the public and a potentially inspiring purpose the local government serves, and more. Many of the assets that put Lancaster in a place to get into municipal power are similar to the assets that other local governments have. These assets could serve as the foundation for other entrepreneurial ventures. The most important assets include:

Skilled staff who are hungry for a new challenge. Because of the large stock of assets that Lancaster owns and manages, it has a great deal of on-staff expertise in engineering and finance. People are often motivated by the chance to apply their skills and meet a challenging goal.³ Hence, the skills of a local government's staff are a store of potential that could be used in the pursuit of new ventures.

A strong public purpose. People are motivated by inspiring goals.⁴ There is evidence that public servants may be motivated by achieving an ennobling public purpose.⁵ In Lancaster, the purpose was to be the first carbon-neutral or "net-zero" city in the United States.ⁱⁱⁱ Solar energy was seen as an important part of the city's plan to achieve this goal. Local governments should have an advantage over private companies in identifying an inspiring goal that serves the community. Lancaster didn't rely just on one public purpose. Though the environmental benefits of renewable energy were the prominent public purpose for

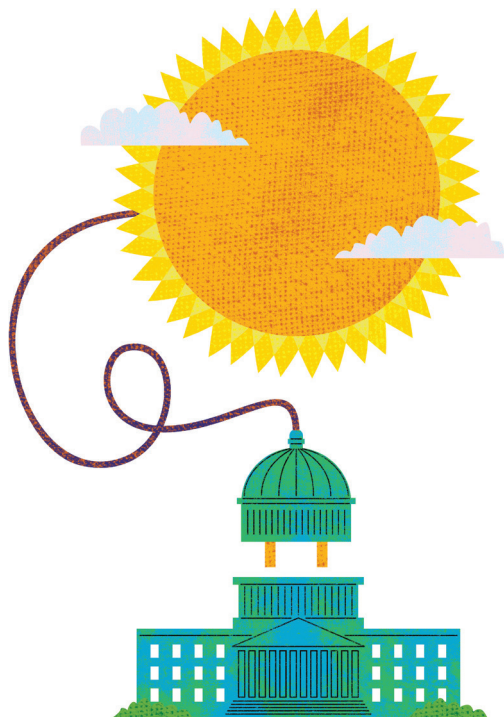


ECONOMIES OF SCALE DEFINED

Economies of scale results in proportionate savings in cost as more units are produced. An important source of economies of scale is spreading the fixed cost of a capital asset over a larger production volume. Many local government services are labor intensive, and capital assets are relatively unimportant. The potential for economies of scale is limited for these services. Asset-intensive services have greater potential.

ⁱⁱ It should be noted that this particular strategy could strike some people as controversial because it involves using the city's regulatory powers for financial gain.

ⁱⁱⁱ Carbon neutral means that the CO₂ emissions put into the atmosphere by the city is the same as the amount of CO₂ emissions the city removes from the atmosphere.



By thinking entrepreneurially about municipal power, the City of Lancaster used only 17% of their energy budget in fiscal year 2020-21.

Lancaster, as we will see later, the city also identified potential benefits to the local school system and citizens' financial well-being as reasons to pursue municipal power.

Underutilized real estate. Local governments often own a lot of real estate, and that real estate is often not used to its full potential.⁶ This could include vacant land, parking lots, or municipal buildings. In Lancaster, these turned out to be great locations for solar panels.

The ability to partner with other local governments. Many local governments form partnerships with each other to achieve a shared goal. This is a huge advantage over private firms. For example, it is common for local governments to form joint purchasing arrangements for goods and services from office supplies to insurance. It is not common for private firms in the same industry to band together in a similar way. Local government's ability to form these partnerships provides access to economies of scale. We'll see how this served Lancaster later in this article.

QUESTIONS AND CONVERSATION STARTERS

- ➞ How do the assets we described compare to assets in your community? What untapped potential do you have on staff? What strong public purpose can motivate entrepreneurial thinking?
- ➞ Who manages your real estate assets? How do you assign value to your real estate assets?
- ➞ Do you have other assets not listed in this article that could support entrepreneurial thinking?

Entrepreneurial Thinking: The Secret to Unlocking Asset Potential

Because the assets we reviewed in the last section are shared by many local governments, these assets alone cannot be sufficient

The City of Lancaster, California (below) is located approximately 70 miles north of downtown Los Angeles and has a population of about 150,000.





After a two-year study covering 280 teams, Google found only one difference between innovative and not innovative teams: psychological safety.⁷

for successful entrepreneurialism by local government—or more local governments would be doing it! What is needed is entrepreneurial thinking. Entrepreneurial thinking for a local government has two main parts: innovation and being risk savvy. Fortunately, these are skills that can be learned and are not unique to local governments like Lancaster.

Innovation

This means being willing to think differently and creatively about how the local government conducts its business. It is not necessary or even possible to rely on an extraordinarily creative Steve Jobs-like figure for innovation (and neither does Lancaster rely on such a person). Instead, innovative thinking must happen in group settings. The key to innovative thinking in a group is psychological safety. Psychological safety is a shared belief, held by members of a team, that the group is a safe place for taking risks. It is a sense of confidence that the team will not embarrass, reject, or punish someone for speaking up.

It describes a team climate characterized by interpersonal trust and mutual respect.⁷ Psychological safety is necessary for challenging deeply held beliefs and assumptions and taken-for-granted ways of operating. To illustrate the importance of psychological safety, consider the experience of software giant Google. Google wanted to know what makes for a successful innovative team. After a two-year study covering 280 teams, Google found only one difference between innovative and not innovative teams: psychological safety.⁸ GFOA's Rethinking Budgeting initiative has identified psychological safety as critical for getting better results from budgeting and has documented examples of local government finance offices that have worked to establish psychological safety. Other research suggests that diversity in team membership can contribute to innovation.⁹ For example, Lancaster engages employees from different disciplines in its entrepreneurial activities (finance, engineering, legal, etc.).

Risk Savviness

Technology firms are often thought of as the archetypes for innovation. Tech firms are also known for “moving fast and breaking things.” A local government, though, must be careful because it has a responsibility to its stakeholders to avoid reckless risk-taking. This doesn't mean local governments must be risk averse. It means that local governments must be risk savvy. Risk savvy means recognizing that uncertainty and risk are inherent to any kind of progress and betterment and then intelligently managing those risks. Here are actions that characterize risk savvy organizations:¹⁰

- ➔ **Weigh the risk of action versus inaction.** Often, people only weigh the risk of action: The action might fail, etc. It is also important to consider inaction: What exposures does doing nothing bring? To illustrate, Lancaster does not have any “lucrative” conventional taxpayers (e.g., the big shopping mall, etc.) but does have a high demand for services from its community. Hence, the risk of doing nothing in Lancaster is financial distress or a dissatisfied public.
- ➔ **Risk is in the eye of the beholder.** People define risk differently. What might be a risk to one person might be a reward to another. For example, elected officials might be worried that the failure of an entrepreneurial venture could hurt them in the next election. Even a city manager with thin support among the city council might be hesitant to take a chance. Hence, it is important to understand how stakeholders perceive risk, then mitigate their concerns where possible, and accept the limits of how far stakeholders are willing to go.
- ➔ **Risks are discussed explicitly.** This means being able to articulate why you are taking some risks and why others are too extreme. Lancaster is fortunate that many of its elected officials are entrepreneurs in their private lives,

so they understand the need to articulate business risk. Other local governments may have the opportunity to enlist members of the local business community in helping to condition local government to think about risk explicitly.

- ➔ **Understanding limits.** Some risk factors are under your control while others aren't. Know the difference, and focus risk avoidance or mitigate uncontrollable risks. For example, Lancaster limited its exposure to power infrastructure (a large cost and hence a large risk) by relying on the existing power grid.

QUESTIONS AND CONVERSATION STARTERS

- ➔ What opportunities do you have to improve psychological safety in your local government? What are steps you can take? Be sure to check out other GFOA research that describes how to promote psychological safety in more detail.
- ➔ Is your local government risk savvy? How might you introduce greater risk savviness into your organization? Are there local entrepreneurs who can help?

How Entrepreneurial Thinking Led Lancaster Into Municipal Energy

First, entrepreneurial thinking led Lancaster to realize that it had an additional asset beyond the municipal assets we have discussed. Because the city is located in the western part of the Mojave Desert, it had the sun! Lancaster also realized there was an opportunity for a new entrant into the energy market. Many traditional energy companies, until recently in their histories, were monopolies. Monopolies are not known for innovation or good customer service. Hence, the city had the opportunity to be the “scrappy startup” in a local energy market where there was room for a new, competitive energy

provider for the consumer. The city had important advantages as a new entrant into the market:

The city's large stock of real estate and assets on which solar panels could be installed. The city had municipal buildings, parking lots, and even a performing arts center that could host solar panels. The city installed its first solar panel on municipal property in 2010.

Second-mover advantage. New entrants into a market sometimes enjoy what is called a “second-mover advantage,” which means that the new entrant can follow the trail that was blazed by the first mover. In Lancaster's case, that meant the traditional power company had already built all the power transmission lines, so the city would not need to invest in that infrastructure to get started. Rather, the city only needed to produce electrons and distribute them using the existing energy grid.

Aligned with the city's mission. As mentioned earlier, solar energy aligned with the municipality's and its community's desire to become the first net-zero, carbon-neutral city in the U.S. Also, solar energy had the potential to generate additional public value beyond protecting the natural environment.

The city's initial foray into solar energy proved successful. The city was able to change energy from an expense in the city's budget to revenue by installing solar panels on city property and selling excess energy back into the energy grid.

This success prompted the city to leverage another of its assets: the ability to partner with other governments. The local school system had a vast amount of real estate holdings. So the city worked with the schools to install solar arrays at 25 facilities, starting later in 2010. In the first year, this generated about \$410,000 in electrical savings for the schools through lowered energy costs. These savings on the schools' overhead costs could be redirected into the classroom, thus improving the quality of education in Lancaster.

The next step was allowing the citizens of Lancaster to buy energy from the city government. Again, this relied on using the existing power grid, so it did not require the city to invest in transmission lines.

The solar panels at Lancaster Municipal Stadium (formerly known as Clear Channel Stadium) supply 98 percent of the stadium's electricity needs on a typical game night.





Competition causes organizations to focus and put their best foot forward. The absence of competition can breed complacency and stagnation.

The city created “Lancaster Choice Energy” under California’s “community choice aggregation” law. This law allows local governments to procure power on behalf of their residents, businesses, and municipal accounts from an alternative supplier while receiving transmission and distribution services from their existing utility provider (six other states have similar laws).¹¹ Lancaster Choice Energy became available to community members in 2015. It procures energy on behalf of community members at a lower cost: 3% average annual savings per customer. This contributes to the financial well-being of Lancaster’s citizens. The energy is partially generated by the city via solar, and the rest is procured from outside providers who use a variety of generation methods, including wind, solar and conventional. The city’s control over Lancaster Choice Energy lets customers procure greater portions of energy from green sources, including a 100% green energy option for customers who want it. The city’s experience with municipal utilities, including rate setting and engineering, supported the creation of Lancaster Choice Energy. Lancaster Choice Energy has proven popular with the community, with 93% of eligible accounts participating.

Similar to how the city scaled up its successful foray into solar panels by partnering with the schools, the city scaled up Lancaster Choice Energy by partnering with nearby cities. Lancaster joined with the City of San Jacinto in 2017 to create the California Choice Energy Authority (CalChoice). This joint organization helps cities in the region access the benefits of community choice aggregation, without having to create their own version of Lancaster Choice Energy. As of this writing, nine other cities, besides Lancaster, are now members of CalChoice. CalChoice helps the participants realize economies of scale by increasing buying power for energy and sharing the costs of legal and legislative support, program administration, and other overheads across the participating cities.

Finally, these experiences have set up the city for other opportunities. For example, the city purchased all streetlights within city limits from the local power company, which used to operate the lights on the city’s behalf. The city calculated that it could operate the lights at a lower cost. Among the sources of the savings are lower energy costs (similar to the savings generated through Lancaster Choice Energy)

and the aggressive use of energy-saving technologies, such as light-emitting-diode (LED) technology. The city has even been approached by a local private firm about participating in a project to convert waste streams to hydrogen power. It is too soon to say if this project will be successful or even if it will get off the drawing board, but, notably, the city’s successes in thinking entrepreneurially about energy have given the city the experience and credibility to be considered a desirable partner by a private firm for other forward-thinking energy projects.

Key Lessons Other Local Governments Can Learn From the Lancaster Experience

Let’s review what other local governments can learn from the Lancaster experience. These lessons apply to any entrepreneurial activity, not just municipal energy.

Make the connection between entrepreneurialism and creating public value. Unlike private firms, local governments do not exist for a financial purpose (e.g., profit). Hence, a local government’s entrepreneurialism must be rooted in creating public value, not just financial value. The more inspiring the value proposition is, the easier it will be to build support and gain commitment for entrepreneurial activities. We saw how Lancaster positioned municipal power as serving public purposes like environmental protection, strengthening the school system, and improving citizens’ financial well-being. Lancaster also connected municipal power to other goals like local autonomy for the community (energy independence) and democratic empowerment (local control over rates and where power is sourced from). *So know the inspiring public value your local government creates, and see how that can support entrepreneurialism.*

It is not public versus private that matters but rather competition versus monopoly. There is often a belief that private organizations are efficient, innovative, and dynamic, while

public organizations are not. Research into outsourcing of public services suggests this may be a misreading of the situation. It is not merely the publicness or privateness of the organization that matters most but also factors such as the presence or absence of competition.¹² Competition causes organizations to focus and put their best foot forward. The absence of competition can breed complacency and stagnation. In Lancaster's case, the city is competing with the local investor-owned utility. This puts the city in the position of the scrappy startup, while the investor-owned utility is the incumbent that hasn't traditionally faced competition. The city has found that existing investor-owned utilities have lobbied for new regulations that would prevent the city from pursuing its energy goals and limit competition! Hence, the private firm is not trying to outcompete the city on price and customer service; it is trying to take advantage of regulation to preserve its monopoly position—hardly the mark of a dynamic private enterprise that benefits the consumer.

That said, it is critical to recognize that “competition” in government does not have to be limited to market-based competition. For example, Allied governments led a tremendous period of innovation during World War II that ushered in new technologies such as radar, computers, jet engines, flu vaccines, penicillin, blood transfusion, and atomic energy.¹³ The competition was, of course, the Axis powers. Similarly, competition from the Soviet Union spurred the U.S. government's Apollo missions to go to the moon. Of course, we don't recommend that local governments get into a war (hot or cold) to inspire entrepreneurial thinking, but this shows that competition can come from multiple sources. For example, GFOA has found that tracking measures (related to an inspiring public purpose) and comparing the measures to some standard (such as benchmarks from nearby communities) can stir competitive spirits.¹⁴ **So don't assume that public organizations are incapable of entrepreneurialism or that they are inferior entrepreneurs to private firms,**

especially when it comes to creating public value. Look for opportunities where a local government's assets plus a competitive environment can support entrepreneurialism.

Know your assets that can support entrepreneurialism. Assets are not limited to infrastructure or land. These assets have great potential for entrepreneurship, but other assets are important too. We saw that Lancaster took advantage of assets like city staff skills and passion for the job, the city's ability to articulate an inspiring public purpose for the community, the local governments' ability to form partnerships more easily than private firms, and Lancaster's location in the Mojave Desert. **So know your assets, but also think broadly about what your assets are.**

Unlock your assets' potential with entrepreneurial thinking.

Lancaster tapped the expertise and experience of its staff to innovate a new, revenue-generating service. Local governments can encourage innovation by fostering psychological safety in teams. Entrepreneurial thinking also demands risk savviness. This means seeing that risk is part of progress and then managing those risks. **So promote psychological safety and be risk savvy in your local government.**

Start small and scale up.

Incremental progress is often the best path for local governments because it allows for small investments to be made, limits the amount of risk taken at each step, and helps limit the amount of change stakeholders must absorb in a given time period. We saw that Lancaster started with solar panels on city government property; then installed panels on school district property; then started selling energy to Lancaster citizens; and then formed a joint power authority with other cities to sell energy to citizens in multiple jurisdictions. **So think about the smallest viable version of an entrepreneurial service you can invest in to find out if it works, then scale from there if the initial investment proves successful.**

Conclusion

Local governments can create new value for the public and raise new revenues by thinking entrepreneurially. This means getting the most out of a local government's tangible and intangible assets through innovation and managing risk. It also means taking advantage of the power of competition to spur innovation and determine the execution of new ideas. Competition can come from market forces, but it can also come from—when framed in the right way—the local government's duty to provide the best value to its community. ■

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¹ Donahue, John D. *The privatization decision: Public ends, private means*. New York, New York: Basic Books, 1989. Donahue points out many other factors that lead to successful privatization, but the presence of competition is essential. The public management practice of “managed competition” applies this insight to outsourcing by maintaining some capacity by local government to provide the service but subjecting the government service to competition by private firms.

² Kavanagh, Shayne C. “Putting Public Assets to Work.” <https://www.gfoa.org/materials/putting-public-assets-to-work>

³ Pink, Daniel H. *Drive: The surprising truth about what motivates us*. Riverhead Books, 2011. Pink describes the research behind what he calls “mastery” as a core motivator for people.

⁴ This is supported by a large body of work called goal theory of motivation.

⁵ Perry, James L.; Hondeghem, Annie; Recasino Wise, Lois. 2010. “Revisiting the motivational bases of public service: Twenty years of research and an agenda for the future.” *Public Administration Review*. 70(5): 681–690.

⁶ Detter, Dag; Folster, Stefan. *The public wealth of cities*. Brookings Institution, 2017.

⁷ Edmondson, Amy C. “Psychological safety and learning behavior in work teams.” *Administrative Science Quarterly* 44(2): 350–83, 1999. Taken from: Duhigg, Charles. *Smarter faster better: The transformative power of real productivity*. Random House Publishing Group, 2016.

⁸ “This is the way Google and IDEO foster creativity.” A undated podcast in the IDEOU “Creative Confidence” podcast series, featuring, Frederik Pferdt, Chief Innovation Evangelist at Google.

⁹ Hewlett, Sylvia Ann; Marshall, Melinda; Sherbin, Laura. *How Diversity Can Drive Innovation*. *Harvard Business Review*, December 2013. <https://hbr.org/2013/12/how-diversity-can-drive-innovation>

¹⁰ Characteristics taken from various thinkers about risk, including Sam L. Savage, Gerd Gigerenzer, and Michele Wucker.

¹¹ Hewlett, Sylvia Ann; Marshall, Melinda; Sherbin, Laura. *How Diversity Can Drive Innovation*. *Harvard Business Review*, December 2013. Description of community choice aggregation taken from the Environmental Protection Agency (EPA). According to the EPA, seven states have such laws. <https://hbr.org/2013/12/how-diversity-can-drive-innovation>

¹² See the first endnote.

¹³ Little, Becky. “6 World War II innovations that changed everyday life.” *History.com*, April 26, 2021. <https://www.history.com/news/world-war-ii-innovations>

¹⁴ Kavanagh, Shayne C.; Reitano, Vincent. *Financial foundations for thriving communities*. Government Finance Officers Association, 2019.