

Chapter XI

EVALUATING CONTRACTING OUT: ESTABLISHING COST/QUALITY COMPARISON GUIDELINES

A Guide to Contracting Out for Public Managers

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Contracting with the private sector for the delivery of public services has been in the news for a number of years now. From every direction we are barraged with “statements of fact” about the superiority of the private sector in performing almost any service. We are lectured regularly that government is inherently inefficient and that only the private sector can do the job.

Yet, is it true that the private sector is always more productive than the public sector? Must the public sector be less effective than the private sector? How can one answer these questions?

There are some factors which would tend to suggest that the opposite situation should prevail. After all, governments don't need to make a profit or pay taxes. They can borrow at lower rates than the private sector. These facts constitute major advantages and can not be dismissed lightly.

The claim of unlimited contracting out protagonists is that it is generally cheaper and presumably of at least equal quality to contract out a service than to perform the same service with in-house employees. What tests of this thesis do we have? The answer is that there have been few tests, and those that have been conducted are seriously flawed.

Something of the difficulty of making broad statements about local governments can be gleaned from an examination of the various weaknesses that can be found in the arguments advanced in favor of all-out contracting. For our purposes we can indicate four major problem areas in the unlimited pro-contracting arguments:

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- Service definition problems
- Cost definition problems
- Productivity problems, and
- Time-frame problems.

Service definition problems refer to the fact that a service in one area of the country may be referred to by the same name in another part of the country, but the actual service provided may be very different. Solid waste collection is a fine example. Indeed, when one is talking about contracting, one always seems to end up talking about solid waste collection. It isn't difficult to see why: everyone THINKS that they are experts on solid waste collection. After all, everyone has trash that they have to get rid of and everyone has seen the types of trucks that collect it; thus, everyone has the problem and knows about the solution.

Actually, the reality of solid waste collection varies considerably from place to place across the country and from month to month in the same place. Some communities collect from the back yard, others from the sidewalk only. Some cities establish collections sites where residents drop their trash on specific days and times and some rural communities only make a public dump available at certain times.

Some jurisdictions have great numbers of large apartment buildings (from which they may or may not collect refuse) and others are almost exclusively single family residences. Given the additional regional variations in the extent of unionization of both private refuse haulers and municipal employees, it cannot be simply stated that the private sector can collect trash more cost effectively than the public sector.

If comparisons of services between jurisdictions are difficult, the determination of the cost of those services presents awesome problems. Put at its simplest, local governments are regarded as practicing good accounting when they can prove that their revenues were collected and disbursed legally. The notion that public accounting must serve the needs of management as well as provide proof of compliance with applicable local, state and federal laws and regulations has made little progress.

The result of this is that the administrative "infrastructure" necessary to provide accurate and useful cost accounting information is not widely available. Most governments have great difficulty in determining the direct costs of a service and the concept of indirect cost is generally little understood. In summary then, accurate cost information is not easily available.

The service definition problem and the costing problem are further compounded by significant issues surrounding the concept of productivity. Even if it could be proved that in a specific community, based on the way a service is currently being delivered, it would be cost-effective to contract out a service, would this be the most appropriate mode of action if it were also known that improvements in the productivity of the service delivery technique could lead to even greater cost savings? Clearly not. The point is that it is unwise to simply compare the current state of service delivery with the alternative of

contracting out; one must also ask if the jurisdiction mightn't be able to do it better on its own.

Another significant issue that is all too often forgotten in discussions of contracting out is the importance of time. Municipal decisions tend to be made against a very short time-horizon: this budget, this year, now. But even if a decision to contract out a service were a cost effective decision this year, will it remain a cost effective decision next year? And what of the year after? Most contracting out decisions pay very inadequate attention to the future. It is fortunate that the one public official whose job requires an adequate sense of the future is the purchasing officer. "Low ball" bids are not a new problem in procurement.

Background

Periodic fiscal crises facing governments at all levels compell public officials and managers to take a hard look at which services they should deliver, and how they should deliver them. Hoping to prevent excessive cutting or elimination of services, many have turned to basic value analysis and the sensible question it asks: how can we satisfy the required function at the lowest total cost consistent with our requirements for performance, reliability, and quality?

One option that is being viewed more favorably by local government officials, in particular, is the notion of obtaining competition from private firms for traditional government "monopolies"; and, when it is in the interest of the local government, purchasing services from such companies. Since most of the services produced or consumed by local governments can be defined, and are available from, private companies (e.g., "direct" services such as refuse collection and "support" services such as housecleaning), it is possible to consider the alternative of an agency or government no longer directly producing a service; but rather arranging with a private company to deliver it. The agency or government still plans and finances the service; but stands to benefit monetarily and otherwise if the private producer, or an agency of the government itself (as a result of competition from the private sector) delivers a better and/or more cost-effective service.

This notion of competition in service delivery seems to offer great potential. However, the process by which competition is actually sought and obtained must be thoughtful, and it must accurately and as completely as possible assess the advantages, disadvantages, and possible consequences of purchasing a service from a private firm.

The "Make or Buy" Decision

Large industrial corporations, when faced with a need for a piece of hardware that is to be used in the production of one of their products, must make a fundamental decision: Is it more sensible (considering total cost, quality, and performance requirements) to buy a piece of hardware from some other company or to make it? If the corporation decides to

buy, it is to some degree dependent on suppliers; if it chooses to make it, the firm may be committing scarce capital resources that perhaps may be better employed elsewhere. It is this kind of a decision that local governments face when determining whether it is in the public interest to “buy” a service (contract-out) or to “make” it (perform the service with in-house personnel and resources).

This stage of the process has also been handled rather informally by most governments. This chapter will provide a detailed approach for a more formal evaluation.

Although cost probably is the major reason why state agencies and local governments consider service contracting, there are some other very important issues which also should be considered in determining whether to “make or buy” a service.

Pro and Con Contracting Out Arguments

Those in favor of contracting out service delivery often argue that contracting out:

- May cost less or provide better performance
- Provides specialized skills on an “as needed” basis
- Limits the growth of government
- Avoids large initial costs
- Permits greater flexibility in adjusting program size
- Provides a yardstick for comparison
- Promotes increased objectivity; and
- Produces better management information.

Arguments commonly raised in opposition to contracting out, in general, say that it:

- may cost more
- may result in poorer quality services for citizens
- increases chances for corruption
- raises the possibility that a service may be interrupted in mid-stream if the private deliverer should go bankrupt
- displaces public employees and draws opposition from municipal unions
- is difficult to draw up adequate contracts for many services
- may be restricted by law
- may entail problems in enforcing public policies (such as equal opportunity employment)
- from a lack of few, if any, alternative sources of supply
- reduces a government’s flexibility to respond to change
- causes a government to have less control over service quality and quantity
- may interfere with community traditions; and
- requires close monitoring.

Certainly, not all of these advantages and disadvantages are valid, in particular circumstances, since each service and the total environment in which it is planned, financed, and delivered are unique.

It would be wrong to say that contracting is never a wise decision, only that it is always a difficult one. One misstep in the decision process can significantly reduce a government's independence and for this reason, considerations of contracting out must be handled with more than usual care.

Like all management options, contracting out has a potential for misuse, for being used for the wrong reasons. One such misuse is to contract out a management failure; to use contracting out to avoid facing and solving a management problem. Management problems rarely can be disposed of in such a way; they just change their form and reappear to haunt the government in a different guise. Problems must be solved not repackaged.

I have stressed the negative aspects about contracting out government services, not because it lacks positive aspects, but because in the general ballyhoo of praise of the private sector it is easy to forget that the goal of public administration is not to minimize expenditures but to implement public policy, in general, and to make our democracy work, in particular. With respect to contracting out, I fear that we might be completely correct about the numbers and completely miss the point about our role as public administrators.

This chapter provides guidelines for contracting with private firms for the delivery of public services which traditionally have been provided by government personnel. It discusses the activities involved in purchasing such services.

Outline of the Contracting Out Evaluation and Implementation Process

Step One: Define the Service

- Performance frequencies
- Performance levels
- Performance monitoring
- Address quality issue

Step Two: Determine the Total and Avoidable Cost of the Service

- Expenditure versus expense

Step Three: The Case for In-house Delivery

Step Four: Solicit Bids

- General terms, ...

- Special terms, ...
- Statement of work
- Sources of Information
- Pr -Overhead rates
- Case Study
- Quality issues

Step Five: Select a Provider

Step Six: Administer the Contract

- Monitoring
- Documenting
- Seeking corrective action

Summary

Step One: Define the Service

The very first step in seeking competition for a service is to know exactly what service is required (which may or may not be the service currently being delivered). While such a step may seem obvious, it is anything but that.

Local governments, in particular, have a tradition of informality that often results in the delivery of basic services without any written definition of their scope, frequency, or quality; or, for written definitions to be changed over the years through practice, but not in writing. Complications may never arise from either practice so long as the service continues to be provided in-house. However, if a decision is made to purchase a service using either an informal definition or an out-of-date written definition, a government or agency may end up in an embarrassing position. Such was the case for one city which signed a well-written contract for sidewalk trash collection only to discover afterward that its public works employees had routinely been picking up trash from backyards — not the sidewalks. The out-of-date written definition had been included in the solicitation document.

A good service definition (i.e., specification or statement of work including tasks, frequencies and quality levels) will indicate as precisely and measurably as possible the type, level, and quality of service that is required; by doing so, it will permit the government or agency consumer to:

- Communicate to the potential producer of the service (be it in-house staff or an outside bidder) what is expected and how performance will be evaluated
- Determine, after the contract is in effect, whether the in-house staff or outside contractor (as appropriate) is performing as required.

In addition, a superior service definition (depending on the type of service involved) may provide a major part of the cost/value bid evaluation methodology which would permit a government to determine how much better, in dollars and cents, one responsive offer is than another (should a jurisdiction decide to accept bids for contracting out the service).

Each service that is to be defined should first be broken down into its component tasks or “elements”. For example, the elements of a jurisdiction’s refuse collection process might include back door collections, curb-side collections, and “special” collections for the elderly; and, for janitorial services, they might include vacuuming of floors, emptying of trash bins, dusting of desks, etc. Individuals who are

- Involved in delivering a particular service for the government, or
- Interested in providing that service for the government, or
- The actual consumers of a service,

are among those who should be consulted in identifying the component tasks or elements of that activity. In particular, service consumers should always be consulted about the character, quality, and frequency of a service since no one knows more about a service than its consumers.

The elements of a service tend to vary by:

- Time
- Service population, and
- Location.

If any of these factors are omitted, there is a significant risk that the resultant service definition will be materially defective and that any contract based on that definition will be unsatisfactory.

An example of a time variation in a service element for refuse collection might be the need to pick up Christmas trees in January (only). The elderly in a particular city may be eligible for backyard collection of trash — an example of a variation by service population. Older neighborhoods might have narrower streets, more apartment buildings and heavy competition for on-street parking. Street cleaning in such a location would be very different from an area with lower density and adequate off-street parking. Such variations in service by location can be a major factor in developing effective contracts for traditional public works functions.

The next step is to assign each task or element a quantified frequency of performance and to identify the standard against which task performance will be verified — its performance level. To the extent possible, the performance level should be measurable and quantified.

As an illustration, the exhibit below displays performance frequencies for floor cleaning from a City of Phoenix contract for custodial services.

Performance Frequencies	
Item	Frequency
Carpeted Floors	
Vacuum Carpet (including under desks, tables, chairs)	Once per week
Remove debris and vacuum traffic areas	Daily
Shampoo (within 30 days)	Once per contract
Spot Clean	As needed
Non-Carpeted Floors	
Dust mop	Daily
Damp mop, spray wax and buff	Twice per week
Strip, wax and buff (within first 30 days)	Once per contract

Performance levels are, if anything, even more important than frequencies because they tend to address issues of quality rather than quantity. Great care and attention to detail should accompany any effort to define these levels. Performance levels from the same City of Phoenix contract for custodial services mentioned above are displayed in the exhibit below.

Performance Level	
Service Element	Performance Level
Dusting	Surfaces shall be free from dust after dusting is completed. Dust shall be removed and not scattered around room. No feather dusting.
Sweeping	Floors shall show no dust or dirt streaks and no dirt or dust shall be left behind or under radiators, furniture, pipes, benches, work tables, doors, corners, or any other object that is not installed or securely fastened in place.

The specification should describe the methods by which performance will be “checked” (i.e., monitored), and, if necessary, corrected. A specification which cannot be verified is of little value. Depending on the service in question, “checking” may involve regular inspections; or, on the other extreme, unscheduled responses to complaints. The “related factors,” which will determine the type of checking method selected, include the importance of the services to the health, safety, and welfare of the citizenry and the

relative importance of the service to the overall functioning of an agency or local government. More will be said about checking and inspection later.

Address Quality Issues

Beyond the dollars and cents of any given decision are serious issues of quality which — while they generally cannot be quantified in any effective way — must be resolved by informed judgment. It is not possible to give a complete list of quality issues that would cover all situations; yet certain questions seems to be regularly recurring ones:²

- How great is the need for the jurisdiction to maintain full responsibility for providing the service?
- How great is the need to control priorities and schedules?
- How great is the need to maintain and assure security?
- How great is the need to quickly respond to citizen complaints?
- Can controls be adequate for the jurisdiction to maintain responsibility for the service?

Prepare a Written Definition of the Service

At this point, the definition of the service, the quantified standards of performance and the implementation plan can be combined to form a statement of work which will be the basis of the bid specifications. This will guarantee that all bids are for the same service.

In the process of defining the service, it may be discovered that by changing how the service is delivered it is possible to maintain or increase quality and/or to deliver the same service at a reduced cost. If the changes are actually implemented, the new cost structure should be used in the subsequent internal bid.

The next step is to solicit bids for a proposed contract, including a bid from the internal city department currently responsible for the service. To avoid hard feelings, it should be clear to the “outside” bidders that the responsible city department will also be submitting a sealed bid that will be evaluated on the same basis as all of the others.

Providing assurance to all parties that the internal bid will be completely objective can be difficult. Phoenix, Arizona resolves this problem by having the bidding department specify the inputs necessary (manhours, machine type and time requirements, etc.) while the auditor’s department converts the inputs to a cost for the bid.

Whenever a service that is considered for contracting out requires major investments in equipment, a multi-year contract (with option to renew for an additional time period) seems essential. It would be very difficult to expect serious businesses to bid unless the term of the contract was long enough to amortize equipment acquisition. To offer a

² City of Phoenix, Arizona, private communication.

contract whose term was distinctly less than the time period necessary to finance the purchase of needed equipment is to discourage serious bidding.

On the other hand, if the jurisdiction already owns the equipment needed to perform the service, it may be possible to structure a bid that will result in the jurisdiction's equipment being used to perform the service. Owning the equipment can significantly increase a government's independence and freedom of action should the contractor fail to perform as needed.

Step Two: Determine the Total and Avoidable Cost of the Service

Perhaps, the most difficult task will be to establish with precision the avoidable cost — and the total cost — of a service delivered in-house. Traditionally, local and state governments have focused their budgeting and accounting on expenditures (reductions in *financial* assets) rather than expenses (reductions in *total* assets). Thus government records for the general fund would show the total expenditure of a purchase of a three year supply of salt in the year in which it was purchased (the year of the reduction in a *financial* asset: money). No further accounting activity would reflect the consumption of the salt (a reduction in an asset: salt) in the years during which it was actually used.

It is important in the costing of a service to know when assets are consumed, since consumption reflects the economic cost of performing a service. Clearly, a system for calculating the expense (true economic cost) of service delivery will have a major focus on inventories and depreciation (reduction in the value of physical assets). Procedures for maintaining the required records and accounting systems are referred to as cost analysis (or management accounting, or cost accounting, or cost finding) and are widely practiced in the private sector. In the public sector the value of cost analysis has only recently received the attention which it merits.

The reader is referred to the earlier chapters of this book for definitions and examples.

Step Three: The Case for In-House Delivery

The benefits of in-house performance of services may be spread around in ways that can be complicated to track. Many services are provided by one municipal bureau to another, based on a “one big, happy family” approach to the tasks at hand (e.g. a public works department may provide specialized wiring for a computer center). The often unrecorded nature of these activities makes them difficult to anticipate and evaluate. Further, the very presence of a pool of in-house personnel creates a strategic reserve capable of being targeted at key problems with relatively little planning.

In addition, in a small community, a pool of employees may provide a number of different services. Even if it is decided that it is financially desirable to contract out one of the services involved, it would probably be unwise to do so unless there were other tasks for the employees to do productively.

Every government contains at least one “jack-of-all-trades” who attends to a wide range of needs with little fanfare. Through an informal grapevine, such people become known throughout certain areas of a government and are often called upon to solve minor problems before they become major ones. Thus, there are operationally significant but structurally intangible benefits to in-house performance of some services.

Just as an agency or local government must be able to define a service if it is to obtain satisfactory performance, it also must be able to establish as completely and objectively as possible the case for providing a service with its own staff and/or management. Several factors will be critical in building the case to stay in-house, including:

- Legal constraints against contracting out certain services or terminating employees
- Personnel, civil rights, and union opposition, and the ability of these groups to translate that opposition into political action
- The extent to which the service may be defined, “costed”, and subjected to competition, and
- The capacity of the governmental unit to administer an outside contract.

Consequently, the general management staff should involve the government’s counsel, the appropriate line administrator, the purchasing officer, and the finance director in establishing (or projecting) the cost, quality, and other advantages and disadvantages of providing the service in-house.

Step Four: Solicit Bids

At this point, the government prepares a solicitation document and uses that document to invite private offers to deliver the service now being provided by, or possibly to be provided by (if it is a new service) government personnel. Like any solicitation document, this Invitation for Bids or Request for Proposals will contain certain fundamental elements, including the:

- General terms, conditions, and instructions (boilerplate)
- Special terms, conditions, and instructions
- The specification or statement of work; and
- Other pertinent information, such as how the contract will be administered.

General Terms, Conditions and Instructions

The boilerplate of a solicitation usually includes information on such items as how to complete and submit bid forms, standard criteria used in evaluating bid price, how errors in bids will be handled, general criteria for the submittal of performance bonds, etc.

Special Terms, Conditions, and Instructions.

This section of the solicitation document contains terms, conditions, and instructions which address governmental concerns that are applicable and peculiar to the service being purchased. They may include:

- liquidated damages provisions
- bonding and insurance requirements
- wage rate provisions applicable to certain trades, when required by local, state, or federal law or regulation
- types of qualification data required of bidders or proponents
- special techniques to be used in evaluating offers (e.g., if bids are received, a “Life Cycle Cost” or “Total Cost” type formula; or if proposals are sought, the evaluation criteria or format), and
- other special information and instructions that are unique to the specific service being purchased.

The following exhibit provides a list of twenty-six special conditions and instructions actually included in an invitation for bids used by the City of Phoenix on a landscape maintenance contract.

Additional Conditions of Purchase City of Phoenix, Arizona
<ul style="list-style-type: none">• Affirmative Action in Employment• Contracts Administration• Bid and Performance Sureties• Risk of Loss• Price• Method of Payment• Insurance• Workmen’s Compensation• Liability• Indemnity and Hold Harmless• Liens• Products Certification• Product Label• Contractor’s Performance• Special or Additional Services• Inspections• Pre-Bid Conference (Mandatory)• Site Inspection (Mandatory)• Safety• Type of Work Supervision• Employee Strikes• Option to Extend• Performance Interference• Key Charge

- Work Schedule
- Designated Representative

Specifications and Statement of Work

The actual development process should have been completed in Step One with the definition of the service. If not, however, the responsible purchasing official should work with the appropriate using agency and, if possible, the local “industry” for that service (not just a single bidder) to develop specifications which:

- Identify required tasks, performance levels and quantity
- Permit and promote competition
- List and describe the methods that are to be used in verifying compliance with minimum requirements (i.e., required tasks and standards of performance); and
- Provide for an equitable contract award at the lowest total cost to the governmental unit.

Evaluate Cost and Quality Issues

The next phase is the bid analysis. **Since the local government is seeking a net benefit from contracting, it is important that the *incremental in-house cost of managing the contract (e.g., inspecting, reporting, complaint handling, etc.) be added to the figure submitted by each vendor.*** If the definition of the service was thorough, the implementation plan forms the basis for making a reasonably accurate estimate of the time and cost of monitoring the contract. It should be noted, however, that researchers have frequently cited the contract monitoring costs as the most underestimated of the whole process.³ (At one point, the federal government standardized the estimation of contract administration costs at four percent of the bid price.⁴) Since all bidders (in-house and out-of-house) will be bidding on the same performance standards for a given service level and under a previously agreed upon process, it is possible to accurately compare the bids.

It is important to note that the bidding process, bid evaluation, bid award (again, whether in-house or not), and final contract should be conducted according to the highest professional procurement standards. Because of this, the local government purchasing agent/contact officer should be involved at least from the beginning of the cost comparison study. Since, in general, the purchasing officer may also be the local official

³ John Rehfuss, “Personnel Factors in Contracting Out.” Prepared for a seminar on “Contracting Out” given in Sacramento, California, October 1981.

⁴ Executive Office of the President, Office of Management and Budget, Cost Comparison Handbook, Supplement No. 1 to OMB Circular No. A-76: Policies for Acquiring Commercial or Industrial Products and Services, Needed by the Government (Washington, DC: 1979), p 53.

most knowledgeable about definition of work and standards of performance, his/her involvement would be very appropriate from the start of the service definition phase.

Sources of Information and Assistance

In preparing the special terms, conditions, and instructions, and the specifications/statement of work for a service solicitation document, a government need not “reinvent the wheel”. A wealth of information and assistance is available from National Institute of Governmental Purchasing (www.nigp.org), other governments, private organizations who purchase the same services as governments, and the local and national trade organizations which represent the various service industries. The NIGP Information Library has service solicitation documents used by governments in the United States and Canada to purchase a large number of services. These documents, of course, were designed for use in a specific environment and should be modified to suit another government’s unique circumstances.

Pre-Bid Conference

When any complex items are to be purchased by an agency or local government, a pre-bid conference can be extremely beneficial. A major advantages of a pre-bid conference is the opportunity it provides both the purchasing department and the potential bidders to clarify misunderstandings and correct errors which could prove costly later on.

Step Five: Select a Provider

Selecting a provider involves weighing the cost, quality, and other possible consequences of providing a service in-house with the cost, quality, and other consequences of hiring a private firm to deliver the service. It is, in effect, a bid (or proposal) evaluation process involving one additional “candidate”: the in-house offer.

Traditionally, the case for staying in-house with most services has been raised, stated, and considered informally, even in periods of fiscal crisis. As long as in-house personnel deliver what general management perceives to be an adequate, cost-effective service, no consideration is given to contracting out that activity. However, once general management determines that a service might be delivered more cost-effectively and/or better by a private firm, the general rule has been (a) to “rough out” the cost, quality, and other advantages and disadvantages of providing the service in-house; (b) to solicit outside offers; and (c) to hire the lowest responsive and responsible bidder. Rarely, if ever, after formally soliciting outside offers, does a government decide to stay in-house. This practice may not be technically correct, but it does describe current practice.

From a professional procurement standpoint, it would be ideal if all offers (including the in-house offer) could be considered and evaluated on an objective basis. Unfortunately, this objective is difficult to attain due to several considerations, including the difficulty of

assigning a precise cost to in-house delivery of a service and the political ramifications of displacing public employees.

Both Phoenix, Arizona and St. Paul, Minnesota, where rather formal approaches to establishing the case for in-house provision are taken, in-house departments have submitted actual bids (not just cost estimates) and bid directly against private firms for the privilege to deliver certain services under contract. Phoenix departments have vied with outside contractors for the privilege to deliver such services as landfill operations, landscape maintenance, trash and garbage collection, and public housing maintenance. Out of twenty-two services put out for bid over a multi-year period, city forces submitted the lowest bid ten times.

Recently, the St. Paul police department won a bid against three outside vendors for the privilege of maintaining its own communications equipment. In both Phoenix and St. Paul the in-house bids are prepared and submitted by the audit department so as to avoid the appearance of impropriety and gain the confidence of outside bidders who might otherwise think that the cards were stacked against them in the bid evaluation process. The audit department reviews the past financial records of the bidding departments together with any planned changes and establish projected costs as precisely as possible.

Step Six: Administering The Contract

Too often there is a tendency for management to assume that its job is done when the contract is awarded. It just isn't true. Contracts do not administer themselves. It is important and necessary to:

- Monitor contractor performance,
- Document the findings of the monitoring process, and
- Take corrective action, if necessary.

Monitoring

Depending on the service, the manner in which contractor performance is monitored (i.e., checked) may involve any number of procedures, including regular and unscheduled inspections, complaints brought to management's attention, reports, or surveys of consumers of the service. Several factors, including the importance of the service to the public welfare and the continued operation of the government or agency, will determine the type and frequency of monitoring.

Inspections, when called for, should be both reasonably often and random. Randomness helps assure the inspector that the observed performance is typical and not something prepared specifically for the service.

The inspection phase is a WRITTEN plan for the frequency of verification of the quantified standards of performance. Generally, depending on the service in question, the frequency of inspections should be both reasonably often and random. Randomness

helps to guarantee that the observed performance is that which is typically in force and not something prepared specifically for the examination.

Other methods used to provide verification of standards range from 100% inspection (most active system) to monitoring only on complaints (most passive system). One hundred percent inspection is usually reserved for exceptionally vital situations where a single lapse would significantly affect public health or safety or be very costly, while complaint monitoring is very useful when the service is provided directly to a large public (such as trash collection) over a geographically dispersed area. When monitoring complaints, first attention must be given to removing (or disproving) the complaint. Fast and efficient communication between the point where complaints are received and the point where resources are available to address the complaint is essential. It should not be forgotten that planning for efficient response can often convert to higher costs. Weighing the additional cost against the sense of public satisfaction is not easy and requires both experience and flexibility.

Frequently it will be desirable to combine several of these approaches to achieve an appropriate level of knowledge of service delivery quality. For example, in many situations the proper inspection procedure would be to combine random inspection with complaint monitoring since the information gained from the random inspections would tend to balance a picture that might be otherwise distorted by a relatively small group of consistent complainers.

For most services the concept of a “standard” should be seen not as a minimum (as they generally are in an “item” purchase), but rather as a base from which variances will occur. The key to maintaining a quality service will be to limit the amount of variance below the standard.

Documenting

There are no cookbook solutions that will allow an agency or government to compare what the contractor is doing with what should be done. Common sense dictates, however, that it is important to record and retain in writing any deviations from specifications encountered during the monitoring process and to do the same with any justifications for such deviations. Only by such meticulous record keeping can the performance “track record” of a service contractor be established as a factual matter and not as opinion.

The exhibit below is drawn from the Purchases & Stores (Policies and Procedures) Manual for the City of Austin, Texas which establishes the procedures for inspecting and documenting the custodial services contractor’s work at the city’s buildings:

Inspection and Documentation of Custodial Work

Austin, Texas

Department heads, having buildings under custodial contracts for janitorial service, will assign someone in the building or in the department to routinely inspect the building, using the appropriate Custodial Checklist, PSD 4145, a, b, c, or d, available from office services section, general services division. When completed, these forms will be turned in at departmental level for review, file and/or other actions, as review of the checklist warrants. Any actions concerning contract violations must be fully documented by use of the applicable Custodial Checklist.

Case files containing all relevant documents — a copy of the contract, the winning bid, any amendments, protocols, correspondence, inspection checklists and reports, applicable memos, etc. — should be maintained for each service contract.

Seeking Corrective Action

Procedures for getting the contractor to correct substandard performance should have several levels of response. The first level, and the one that would be most often used, might consist of a phone call to the person responsible for managing the delivery of the service in question. While in most cases the matter would end here, there should be written procedures to handle those situations in which verbal communication does not do the job.

The next exhibit displays the procedures established by the City of Austin for correcting the custodial services performed under contract at its buildings.

Corrective Actions for Substandard Custodial Work

Austin, Texas

- When contract violations or discrepancies occur, the department representatives will report cleaning discrepancies of a justified significant recurring nature in writing (may use copies of inspection checklists) to the contract janitorial firm. Repeated significant violations shall be reported in writing to the supervisor of general services division.
- General services' supervisor will advise the contractor of the discrepancy in writing. The department representative will monitor to confirm that the problem has been corrected. If not corrected, advise supervisor, general service division, of the lack of satisfactory corrective action.

In some cases, the contractor will not or cannot correct his performance, at least not immediately. Depending on the particular circumstances, and the wording of the contract, the agency or local government may have to cancel the contract and:

- Exercise its rights under a liquidated damages clause in the contract, or
- Invoke the performance bond.

Summary

Much of the current literature on contracting for services gives the impression that purchasing services is somehow radically different from purchases of other items. Contracting for services does have its own peculiarities, but so does contracting for heavy equipment, contracting for agricultural supplies, and so forth. Basic procurement principles are fundamental to the purchasing of services as they are to purchasing of all other items used by state agencies and local governments.

Purchasing officials can and must play a useful role in helping their management team determine how public services can be provided at the lowest total cost consistent with the agency or local government's requirements for performance, reliability, and quality.

Possible Problems with Contracting Out

Even though contracting with the private sector can be an efficient technique for delivering services in a cost-effective manner, it is important to understand that it is no panacea for municipal financial or service-delivery ills. At best, contracting out can help control costs and increase efficiency; at worst, a badly planned or poorly executed contract can reduce service levels and produce a net loss to the local jurisdiction and its citizens. The key objective of contracting out is to inject competition into the delivery of the local government's services and thereby obtain greater value for the taxpayers' dollars.

Even the best designed plan will still encounter some difficulties and potential obstacles. These might include:

- negative union reaction
- the risk of a "low ball" bid; and/or
- the risk of unintended and undesirable side effects
- inadequate competition in the private sector

Contracting out is a complex labor relations issue. Unions resist it because they believe it will cause a loss of existing or future members and concomitant loss of dues. Clearly, whether or not contracting results in a loss of union jobs, contracting dramatically alters the labor relations environment.

Union Reaction

Union reaction to contracting can vary considerably. In one community, the same union organized both the private trash collectors and public works personnel. A proposal to contract out trash collection met with little resistance because no union jobs were at stake. On the other hand, union reaction can be bitter. In all cases, local government must work at good labor relations and, to the extent possible, involve labor in the decision process. A decision that is understood, even if it is disliked, will be received better than one that is imposed without consultation.

“Lowball” Bidding

The practice of “low ball” bidding (where the initial bid is artificially low to win the contract with the intention of a steep increase in later years to recover lost profits) occurs in government contracting. One way to avoid this is to require bids to contain a clause allowing the local jurisdiction, at its own option, to extend the contract for several years beyond the original year. Lack of knowledge of the true costs of providing a service is not limited to the public sector; any purchasing agent can relate war stories about submitted bids that are so low as to be completely unreasonable. Requiring bid bonds and performance bonds can help avoid the worst problems.

Side Effects

Unintended side effects refer to situations such as the case of the community that contracted its trash collection to the private sector, laid off its labor force, and then had no one to plow the streets during a snow storm. Clearly, there is no substitute for fully understanding all municipal services and their interrelationships. A complete analysis at the beginning can avoid numerous problems later.

Lack of Competition

The role of competition in effective contracting is well illustrated by the experience of Minneapolis in the early 1970s. The responsibility for trash collection was divided between the city (40 percent of the area) and several dozen small private firms (the latter grouped into a single corporation for administrative purposes). Initially, the private collectors were more efficient in both cost per ton and cost per household. As time passed, however, the city gradually closed the gap to the point where it actually became more efficient on a per household basis. When the cost of monitoring the contract was factored into the contracting cost, the city was more efficient than the private contractors.⁵

The situation that prevailed in Minneapolis may not be applicable in all communities, but the value of competition is. At every stage in the make or buy decision process, each

⁵ For details see E. S. Savas, “*An Empirical Study of Competition in Municipal Service Delivery*,” in Public Management Forum (November/December 1977).

decision should be evaluated for its impact on competition; for example, should heavy equipment be disposed of or rented to the service vendors? The right answer to this question is whatever produces the maximum amount of competition. A contracting effort that falls prey to monopolistic practices is likely to be unsuccessful.

One principal reason that contracting out can be a cost-effective method of delivering public services is that competition within the private sector helps to control costs and maintain standards. For some services in some locations however, the private sector may be too small to allow for strong competition. In such instances it may be possible to seek additional bids from other governmental units.

Conclusion

Contracting with the private sector for the delivery of public services is a vast area, much of it uncharted. Local officials who seriously consider contracting out as a service delivery option must examine in great detail many issues either not dealt with in this volume or dealt with only in passing. These issues might include the possibility of intergovernmental contracting, the political aspects of contracting out, legal obstacles to contracting out, employee attitudes to contracting out, and the impact of contracting out on labor relations.

In the final analysis, the decision of whether or not to contract with the private sector for the delivery of a service involves a host of sensitive and complex considerations. Local officials contemplating the option must concern themselves with many factors that are difficult to assess and that require subjective judgment, such as the potential effects of contracting out on quality, local control, flexibility, and dependability of supply.