OVERCOMING OPERATIONAL OBSTACLES TO PRIVATIZATION: THE ART AND CRAFT OF CONTRACTING

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Introduction

In earlier work, we noted that the quality and cost of government services can substantially influence a nation's ability to compete in a global marketplace. One method used by public managers is to improve the management of government programs is to utilize the techniques such as team management, privatization, reengineering, benchmarking and quality management. (Cohen and Eimicke:1998) Of these innovation techniques, the one used most frequently is contracting out to private for-profit and nonprofit organizations to help deliver public goods and services. While this trend may reflect an ideological preference for smaller government, public manages have correctly concluded that they will more successfully implement public policy if they learn to work with private organizations.

There is a good deal of scholarship devoted to analyzing the decision to use contractors and to providing advice to decision makers about how and when to contract out. (Avery: 2000) A number of scholars express doubts about contracting out (Harrison and Stanbury:1990, Hirsch: 1995, Sclar: 1994, 2000) Some analysts have expressed concern about the long-term impact of contracting out on American democracy. Perhaps the most compelling of these analyses is Brinton Milward's path breaking work on what he calls "the hollow state". (Milward: 1994, 1996, Milward and Provan: 2000). The notion is that it is difficult to manage a program and assure accountability if government no longer has direct control of the organizational capacity to deliver programs.

Bardach and Lesser raise the issue of accountability to particular parties versus accountability for results. They note that before developing accountability mechanisms one must decide who management is accountable to and/or what government is accountable for. While concerns about the hollowing out of government are important, and worrisome, increases in contracting activity are widely reported (McDavid, J. and Clemens. E: 1995, Green: 1996, Light: 1999). A number of observers have discussed the need for more sophistication in government contract management (Johnston and Romzek: 1999, Romzek and Johnston, 1999, Gordon: 1998, O'Looney: 1998). Whether one favors or opposes contracting out, its growth is indisputable. Those of us in the business of advising and training public managers must learn to understand this management tool and teach public managers how to use it more effectively.

We anticipate a continued trend toward contracting out by governments. In our view this mirrors the outsourcing trend in the private sector. As we noted in an earlier paper (Cohen and Eimicke, 2000) the trend toward multi-sectoral public service delivery creates several critical and difficult operational problems that must be addressed, including:

- Finding out what contractors are doing;

- Developing and implementing systems of contractor incentives;

- Getting a fair price for services, and;

- Developing the skills needed to negotiate contracts and manage contractors.

The importance of performance measurement to managing contractors has received a great deal of attention, as scholars have sought to identify the conditions that lead to successful out-sourcing (Wulczyn et. al.: 2000, Campbell and McCarthy: 2000, Cohen and Eimicke: 2000(b), Heinrich: 1999, Panet and Trebilock, 1998). In an earlier piece we discussed the reason that performance measurement is so critical to contract management :

> "Management of interorganizational networks and contracts means that leaders cannot depend on traditional hierarchical controls to influence the behavior of subordinates who are responsible for performing particular tasks. This means that management cannot use organizational culture, personnel promotion, demotion, termination, or authoritative command structures to influence behavior…In contrast, contractual relationships with private and nonprofit firms provide the surest way to punish poor-performance: contract termination. While there are limits to the use of this technique- it is difficult to terminate contracts in mid-term- they do provide incentives that are clearly understood by the people who work in the organizations holding the contract". (Cohen and Eimicke, 2000: pp. 101-102).

We have also written about the use of performance measurement techniques for learning about contractor inputs, work processes, outputs and outcomes. (Cohen and Eimicke, 2000):

"The need for vertically integrated, hierarchically controlled organizations has been reduced as technology has made it easier to communicate ideas and information and transport goods and components of goods around the world. Satellite communication, cellular telephones, hand-held computers, containerized shipping and multinational organizational networks make it possible to create goods and services in a variety of locations. These goods and services can be assembled throughout the globe, from components made all over the world. They can be tailored for use in a particular location or market. The creation of a world-wide system of production means that organizations must constantly ask and then reexamine the "make or buy decision": should we do this task in-house or hire a consultant or another firm to do this work for us?" (Cohen and Eimicke: 2000, pp.99-100)

While we believe that public managers are capable of managing contracts and contractors, this management task requires new skills and training for those managers. As we noted in an earlier paper: "Contracting not only solves problems,. it creates them as well. We must learn how to identify and solve the problems that contracting creates." In that earlier work (Cohen and Eimicke 2001) we identified and addressed the following problems created by government contracting :

1. Flawed Request for Proposal (RFP) and or contract language.

2. Overly bureaucratic contracting procedures resulting in delays and high transaction costs.

3. Too few bidders and/or contractor monopolies.

4. Poor communication between government and contractor management.

5. Poor communication between government and contractor staff.

6. Inadequate direction from government to contractors.

7. Contractors that give an agency's work a low priority.

8. Insufficient contractor staffing, training, equipment and facilities.

9. Poor contractor management.

10. Political opposition to contracting.

11. Political interference in contractor selection or management.

12. Underestimating or overestimating resource needs for contractor-performed tasks.

13. Insufficient or excessive profits.

14. Inappropriate or outmoded performance measures and insufficient systems for communicating performance data.

15. Incomplete methods for auditing performance reporting.

16. Inadequate methods for incorporating performance data into government and contractor decision making.

17. Misdirected or inadequate contract incentive provisions.

18. Conflict of interest issues.

19. Union opposition to contracting.

20. Media and political attention to contractor failures.

The Skills Needed to Manage Contracts and Contractors

The list of obstacles to contracting could be duplicated for any management task. It is the job of those of us who teach managers or who manage managers to identify and impart the skills required to successfully overcome these obstacles and manage the process of contracting.

Letting A Contract

The process of letting contracts involves skill at;

- Contract drafting and structuring tasks and incentives.

- Performance measurement.

- Advertising for contractors.

- Assessment of contractor capabilities.

- Understanding the laws, regulations and standard operating procedures governing procurement.

- Understanding the business that is the object of the contract.

Drafting Contracts. Program managers who hope to implement some part of the program they manage with outside help must understand the shape and form of contract language or have a staff person who can do this. A deep knowledge of contract law would be helpful, but is not needed for this task. A staff person with a great deal of experience in drafting contract language or in working on procurement will suffice. Inevitably, the procurement office will review or draft the contract's language and that office will have access to legal assistance. The program's manager will need to have someone on staff capable of communicating with these internal agency procurement

experts and must be experienced at balancing technical procurement concerns with the program's needs.

Performance Measurement. The contract must include reporting requirements that obligate the vendor to participate in the government's performance measurement system. This means that staff expert at performance measurement must be involved in the process of drafting contract requirements. Again, someone with experience in drafting contract language must be involved to ensure that the organization that wins the contract is formally obligated to participate in the agency's performance measurement and management systems.

Advertising for contractors. Most governments have formal requirements for advertising requests for proposals (RFPs) or requests for qualifications (RFQ's). Federal contracts must be listed in Commerce Business Daily and many states require newspaper posting. While these are necessary steps they are not always sufficient to elicit a large enough number of high quality bids. In some of the newer areas of privatization government may learn that there are no qualified vendors interested in bidding on the contract. Government's dominance of the service may have reduced the probability of a private vendor entering the field. The price structure for the contract may be too low due to off-budget infrastructure or capital costs that do not come out of the contracting agency's budget, but must be incurred by a contractor . It may be that the true costs of contracting are lower than direct government service delivery, but the government agency letting the contract does not pay the full cost of delivering the

service. These issues must be fully analyzed before the decision to contract is made. Subsequent to an affirmative decision to contract, the government must work to ensure that private organizations are encouraged to submit bids and that the cost and fee structure is realistic. Sometimes it may be necessary to contract with a firm to develop the capacity to provide the good or service that the government wants to purchase.

The skills involved in finding qualified contractors include business and cost analysis, but analysis alone is not sufficient. What is required is a kind of "business sense". This is where contracting, becomes art rather than science. In the private sector the skill is held by purchasing agents, who know where to find ample quantities of supplies at the best possible prices.

Assessment of contractor capabilities. Once bids are received, government staff must be skilled at reading proposals and judging capabilities. This means the staff must have the ability to read into the statement of qualifications to determine what is real and what is not. They also must be able to check on the accomplishments that organization cite in their bids. A firm or an individual may claim credit for the work of other organizations. Sometimes these other organizations may be part of a team that the bidder worked with on a previous assignment. Strictly speaking, the bidder may be entitled to claim the work of a subcontractor as their own, but if this subcontractor is not part of the new bid, such a claim is misleading. This type of reference check requires that your staff have an informal network in the business are in question. In new areas of

work, it may require structuring a pilot test or a competition among several "best and final" bidders.

Many contract review processes have a point system to assess the quality of the bid. That system can make it difficult to award the contract to the most qualified bidder if the weighting system is poorly designed and places value on factors that turn out to be irrelevant. Moreover, the actual scoring of a proposal is far more art than science, and depends on the subjective assessments of the review panel. In the end, initial contractor selection always involves an element of risk. The key is to learn from mistakes, and build a core of staff with experience in analyzing bids. When you have found a good vendor, try to assess the qualifications that contribute to the firm's success in doing your work and design re-bids to elicit those qualifications.

Understanding the laws, regulations and standard operating procedures (SOPs) *governing procurement.*   Government purchasing requires you to understand an arcane and complicated set of laws, rules and SOPs. An understanding of these procedures is needed to deal with the agency's internal lawyers and experts that govern contracting. If you do not have an expert loyal to your program and purpose than you are at the mercy of your agency's internal process experts. Many of these folks have trouble remembering the purpose of the agency, let alone the importance of your contract in implementing an important piece of public policy. You need to remind them, but in a language they understand—the language of contracting.

Understanding the business that is the object of the contract. Finally, to let a

contract you need to have someone on your staff who has either worked in or has a

deep knowledge of the business you are contracting with. This is one reason that on

construction projects developers typically hire a general contractor. All the general

contractor does is manage the work of other contractors. The most competent general

contractor has staff that have worked in all aspects of construction and know "where the

bodies are buried"—they know the tricks of the trade. They are more difficult to fool, and

are good to have on your side and working with you rather than against you. When

contracting for a service or a product, your best defense is a staff person who knows the

business, how it makes money, and where things typically go wrong. This will enable

you to structure your RFP and the contract itself in a way that increases the probability

of success.

Managing A Contractor

As difficult as obtaining a contractor is, it is even more difficult to manage the

work of a contractor once they have awarded a contract. The process of

managing a contractor involves skills at the following tasks:

- Understanding the purpose of the contract, and the work it is designed to

  elicit.

- Communicating agency needs, culture, constraints and mission to the vendor.

- Communicating the firm's capability, culture, constraints and incentive system to colleagues within the government.

- Deploying incentives and disincentives to the contracting firm.

- Understanding and monitoring contractor accomplishments.

Understanding the contract's purpose. A person on staff must be assigned the task of communicating with and managing the work of the contractor. In a complex contract this might need to be a team of people. In order to do this job, the staff must be clear on what the contract is designed to accomplish. At times, the final RFP might resemble a compromise within the agency. By the time the contract is let, operational ambiguity must be eliminated, if at all possible. If the government agency is not certain of the purpose of the contract, what chance does the contractor have to understand what they are supposed to do?

Communicating to and from the vendor. When two organizations interact in the performance of critical tasks it is important that they develop an understanding of each other's capacity and culture and an empathy for their colleagues in the partner organization. The skill required is the ability to communicate opportunities and obstacles, while keeping the work process moving. This requires a skill at developing informal networks and in developing and maintaining trust. It requires constant effort to stay on top of the shared activity underway by the two organizations.

Deploying incentives and disincentives. In addition to communication, contract management requires a person skilled at understanding motivation. What is it that elicits effort from the contractor? What types of punishment can help prevent large-scale mistakes? Cash incentives may working some instances, but government should not assume that money is the only incentive that works. Nonprofit organizations may be motivated by shared mission, technical experts might be motivated by access to interesting task or new equipment.

Ensuring Ethical Practices.   Government contracting is big business. While George Washington Plunkitt thought to distinguish honest from dishonest graft in the early twentieth century of New York City's Tammany Hall political machine. (Rirordon: 1963, pages 3-6), government officials are now held to higher standards, and even the appearance of impropriety must be avoided. In Plunkitt's day, buying the land needed for a new public park our reservoir was simply "seeing your opportunities and taking them", today it is fraud that can land you in jail. The rules of ethical behavior may be painful to follow, but they are really not very complicated. Avoid rewarding friends and family with the government's largesse. If a friend or family member is bidding on a contract, recuse yourself and ask other officials to judge the bidding.

Understanding and monitoring contractor accomplishments. Finally, staff must learn to track and fully understand the outputs and outcomes of contractor work. This requires visits to the contractor's offices and to any field locations were work is done and where customers may be present. It involves a profound understanding of the

nature of the contractor's work, and an ability to separate real work from symbolic acts. Not only should the agency's staff receive and analyze performance reports and other forms of regular feedback, but they should ensure that independent reports and audits of performance are conducted with some frequency. Government staff should not only rely on the perceptions and judgments of others. They should learn to assess performance, and extrapolate contractor overall performance from key indicators. Understanding the science of performance measurement is a key part of this skill set, but it is not the entire set of required skills. Government staff and management must develop "gut instincts", based on experience and lore to assess and improve contractor performance. This requires a respect for senior staff who have managed contractors before, and an attitude that questions conventional wisdom and easy answers.

Obtaining and Deploying the Skills Needed to Manage Contracts and Contractors

Letting contracts and managing contractors is not simple and far from automatic. If it is so hard to do, why bother? The answer is that modern service production requires high levels of specialized skill and complex, up-to-the minute information. Large organizations set up as traditional vertical hierarchies are not as good at performing these functions as smaller, more agile, less hierarchical networks of organizations. This is not a finding that can be verified by organizational theory, but is demonstrated by data on increased levels of contracting out by government and out-sourcing in the private sector.

We have outlined a large number of skills needed to let contracts and manage contractors. How are these skills to be obtained? What kind of people must be hired? How are they to be trained and deployed? In general, our approach is to proceed simultaneously on two paths. The first is to develop creative methods for letting contracts, tracking and rewarding contractor performance. The second is to self-consciously have more experienced staff mentor less experienced staff and develop mechanisms for "learning-while-doing" and codifying the lessons drawn from experience.

Creative Contracting. With increased contracting and outsourcing, we have noted the growth of creative contracting practices. One example is using the web to elicit contract bids and receive proposals. Another is to use the web as to routinize and speed performance reporting, measurement and analysis. The web is also being used by smaller cities to elicit contract bids from national firms. Another creative idea is the use of performance incentives. For example, each day the subway track repair is completed ahead of schedule the vendor receives a $10,000 bonus, each day it is late they are penalized $10,000 off their fee. Another example is shared overhead: Teams of contractors including multiple subcontractors is a very old practice, but some team arrangements now include shared facilities and equipment as a means of reducing overhead costs.

Another new contracting practice comes out of the quality improvement movement. Prime contractors, subcontractors and government clients meet to attempt

to solve operational and management problems. They review a collective production process, discuss management and logistics issues, and try to reduce communication gaps. If client direction is late or vague, or if a subcontractor needs a supply from another sub that is late, these discussions can help solve problems.

Benchmarking contracting mechanisms with other jurisdictions should be a good way of discovering innovative contracting practices. As contracting increases, we should expect to see new practices develop and new methods of working with vendors and improving their performance.

Mentoring and learning by doing. Despite the increased level of contracting activity, contracting is not a new practice in American government. Don Kettl mentions George Washington's complaints about the shoddy work of contractors during the American revolution. (Kettl: 1988 p. 22) Governments, by necessity "buy" a great deal more than they "make". The work of letting and managing a contract is considered less important by senior government managers than it should be. Agencies should devote more attention to debriefing their best contract managers and getting them to impart their wisdom to more junior staff members.

There are a number of formal contract mechanisms that can be employed depending on the good or service being contracted (O'Looney: 1998, chapters 2 and3). There are different methods that can be used to set the contracts pricing structure, ranging from "time and materials", to "costs plus fixed profit", to "fixed service fees", or

what John O'Looney has termed "per unit payments" (ibid. pages 79-87). There are also a wide variety of reasons that contracts are entered into (ibid. pages 181-187). These in turn result in a range of relationships between the government and the contractor (ibid. page 189).   We strongly agree with O'Looney's assertion that:

> "Building trust or positive interdependence in contract relationships must begin with trust-enhancing measures on both sides. However, the government's contract manager must take the lead in making this effort a meaningful one, as it is usually inactivity on the part of government that allows a contractor to wander into a state of non- or poor performance" (ibid. page 195)

O'Looney then identifies methods that can be used to build the trust relationship between government and contractor and we have also discussed these relationship-building steps in earlier work (Cohen and Eimicke: 2001) The key issue here is how do staff learn how to do this? How do staff learn to select contract mechanisms and pricing structures? How do they learn to establish the correct and most effective relationship with a vendor? How do organizations institutionalize this learning process?

In our view, the first step in this process is to identify the need to manage contractors as if their work were an integral element of the agency's organizational effort. This means that the program office involved in the task must learn the details of the contracting process and not simply leave it to a central contracting office. These details condition and set the boundaries for the type of working relationships that can be established with contractors.

The second step of the mentoring and learning by doing process is to establish a team of experienced experts as mentors and train them to teach contract management. The third step is to establish a set of organizational routines that involve these senior staff in training junior staff. A fourth step is to involve senior staff as consultants in the early stages of a contract solicitation and management process. The fifth and final step is to imitate the sneaker company and "just do it" (steps 1-4). All of this presupposes that you have senior staff with experience in managing contracts and contractors. What should you do if you do not have such staff? You have two choices: Hire at least one person with this background or, hire a consultant to help your staff learn how to manage contractors.

Once you have brought this practice into your organization, it is important that you retain the lessons you are learning, and develop methods for sharing information throughout the organization. It is particularly important to learn from mistakes, and to try to avoid their repetition. Contract management tasks must be factored into the organization's resource planning. These tasks should be part of individual performance appraisal and organizational performance measurement and management. The goal is to make the function of contracting out a seamless element of an organization's typical work and management.

Conclusions: Implementing The Art and Craft of Contracting

Much of the academic literature on contracting is devoted to its long-term impact on government operations and on society. The purpose of this piece is to contribute to the process of exploring the operational management challenges caused by increased contracting. The issue we are concerned with is the effective utilization of outsourcing as a management tool. In what ways do organizations need to adapt to become effective contract managers? What skills are needed? How are those skills developed and maintained? These issues may be prosaic from the standpoint of academic inquiry, but they sit at the center of the concerns of practitioners. What must I do to get better at using contractors? How do I build the capacity to outsource effectively?

The use of contracts, while not new, is becoming a central task of public management. Just as we focus MPA students on financial management, information management, policy analysis, political management and human resource management, we must now add contract and contractor management to that core list of analytic and managerial skills. We need to ensure that our case literature focuses more attention on contract management. We need to remove contract management from its subterranean home—as a topic only fit for the worst sort of drones, and move it to the heart of the field of public management. Its effective practice is an art and a craft that builds on lessons taught in all of the other management fields. It builds on the techniques of team management, performance measurement, financial management, strategic planning and conflict resolution and integrates them within the task of finding quality contractors and inspiring their best possible work.

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