TOWARD A FRAMEWORK FOR MANAGING HIGH-RISK GOVERNMENT OUTSOURCING: FIELD RESEARCH IN THREE ITALIAN MUNICIPALITIES

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ABSTRACT. Many public sector organizations use outsourcing in an effort to take advantage of a private contractor's experience and economies of scale, thereby allowing them to provide high quality public services at a low cost. Although it has received considerable attention in the public policy and management literature for almost three decades, outsourcing has not always achieved a municipality's goals. To address the strategic and managerial issues of outsourcing, we combine a literature review with data obtained from a field study of three Italian municipalities. The resulting framework can assist public sector managers to determine both the services that are the best candidates for outsourcing, and the issues that must be considered in managing the chosen vendors to guarantee high quality and cost-effective results.

INTRODUCTION

Outsourcing is a strategy used by many public sector organizations (PSOs) in industrialized countries in an effort to provide high quality public services at low cost. The underlying theory is that, by contracting with a private sector vendor to provide services (and sometimes goods), a PSO can take advantage of the vendor's considerable experience and economies of scale. In addition, the popularity of public sector outsourcing is related to the growing emphasis on entrepreneurship in managing public services so as to stem the growth of the public sector and exert greater control over spending (Savas, 1982; Osborne & Gaebler, 1992; Hammer & Champy, 1993).

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The PSOs we discuss in this paper are municipalities, where the topic of outsourcing has received considerable attention in the public policy and public management literature for almost three decades. During that time, many municipalities have undertaken a wide variety of outsourcing initiatives, including such disparate activities as animal control, air traffic control, legal services, fire protection, trash collection, health care, snow plowing, building maintenance, bill collection, data processing, street cleaning, street repair, and recycling.

In Italy, where we conducted our research, extensive local government reforms that began in 1990 have created an impetus toward outsourcing. At present, some 27 percent of Italian local services are provided by privately-owned companies, and 40 percent are outsourced to companies owned by the public sector (Antonioli, Fazioli, & Tiraoro, 2000).

Unfortunately, outsourcing has not always achieved a municipality's goal of high quality services at reduced cost. In part, this is because some municipalities have not managed their vendors as well as they might have. Indeed, according to some observers, a municipality frequently becomes seduced by a vendor's alleged competence to provide high quality services with a relatively small (or no) incremental investment in infrastructure assets. As a result, the municipality's managers fail to identify the costs that the city or town will incur in conjunction with the outsourced activity (Demsetz, 1968; Williamson, 1975; 1981).

In part, a municipality's "transaction costs" in outsourcing are caused by the information asymmetry that exists between it and its vendor. In addition, however, the municipality's senior managers frequently fail to consider the risk associated with the outsourcing decision. This risk has been addressed in terms of (a) increased dependence on external suppliers, resulting in a potential loss of control over essential activities, (b) greater difficulty in cost management when there are adversarial relationships, (c) loss of essential competences in the public entity, (d) loss of control over suppliers of the resources (inputs) needed to conduct the outsourced activity, and (e) loss of flexibility in response to the needs of the citizenry (Kettl, 1993; Quinn & Hilmer, 1994; Domberger, 1998; Sclar, 2000).

In this paper, we focus on the risk aspects of outsourcing. We use a combination of a literature review and the data obtained from a field study of three Italian municipalities to develop a framework for risk assessment that can provide guidance to municipal managers to determine which services are potentially of high risk. We also identify several issues that a municipality's senior managers must consider if they are to assure their citizens that the vendors of high-risk outsourced

services are providing appropriate value in terms of both quality and cost-effectiveness.

OPERATIONAL AND THEORETICAL ROOTS OF OUTSOURCING

For at least 30 years, public management has been characterized by efforts to ensure efficient and effective public services (Nolan, 2001). These goals are at the core of the New Public Management (NPM) paradigm (Hood, 1991; 1995), and have been at the root of many reforms around the world.

In conjunction with the NPM paradigm, many municipalities have turned to outsourcing for both internal and external activities as a way to improve the quality and cost-effectiveness of their services. Internal activities are those that reside within the municipality itself, where, the citizenry is unaware of, and largely unaffected by, the outsourcing decision. An example is a choice between an internal publications department and the use of an outside printing company.

By contrast, external activities affect the citizenry directly. Waste collection, snow removal, and street repair are typical examples. Here, regardless of whether outsourcing is used, the citizenry is aware of the services being provided, directly affected by them, and usually very concerned about their quality. When a municipality outsources such services, it reduces its ability to control directly their quality and cost-effectiveness. Indeed, since the vendor frequently is a for-profit entity, the municipality also must be concerned with the conflict between vendor profitability and its broader social goals for the citizenry.

Assessing Outsourcing Risk

The potential conflict between profitability and social goals means that, despite its considerable potential for improving the cost-effectiveness of public services, outsourcing can be difficult for a municipality to manage. The managerial difficulties frequently are bifurcated between the legal issues that arise in preparing an appropriate contract, and the measurement and reporting issues associated with monitoring the vendor's performance (Osborne and Gaebler, 1992: 87). While the former has received considerable attention, especially in the economic and legal literature, the latter has often been viewed simply as "a systematic procedure to monitor the performance of the contractor and compare it to that specified in the contract" (Savas, 1987: 270). Yet, there is a possibility that some vendors, while abiding by the "letter" of the contract, will engage in "quality shading" (Hart *et al.*, 1997: 1148), i.e., they will make marginal reductions in quality (and perhaps features) in an attempt to save costs.

In addition, because cities and towns use a wide variety of outsourcing arrangements, it is not possible to develop a single model that will serve all of a municipality's relations with its vendors equally well (Kettl, 1993: 37). If, for example, a city outsources its publications department, the quality and service goals can be stated relatively easily in the contract (e.g. turnaround time, maximum number of reworks, etc.), all of which can be monitored with little difficulty. Moreover, there is a low risk to the citizenry because of poor vendor performance.

But what about activities such as waste collection, water supply, street lighting, animal control, and many other services where the quality and service goals are more elusive and where the citizenry is more directly affected by a vendor's performance? Can the goals be stated clearly enough to be monitored? Can monitoring be as easily focused as it can for a publications department? Is monitoring enough? In answering these questions, a municipality needs to begin with a *risk assessment*, which has three dimensions—citizen sensitivity, supplier market, and switching costs.

Citizen Sensitivity. From the citizens' perspective, a town's waste collection service clearly is much more important than its publications department. Citizens are worried about the timely removal of waste and only marginally, if at all, about printing quality. In large part this is because, when they are the *final clients*, the risk of non-performance on their satisfaction is much higher. As a result, any outsourcing decision must consider how the municipality's citizenry would be affected if a vendor performed poorly.

Supplier Market. The supplier market can be characterized by its degree of competitiveness, ranging from many potential suppliers (high competition) to few or perhaps only one potential supplier. For example, there usually are many companies competing for a municipality's printing business, but there may be only a few vendors capable of providing good quality waste collection services or nursery school education. As the number of potential suppliers decreases, the municipality's leverage in negotiating with them declines, and its ability to benchmark their performance becomes hampered.

Switching Costs. Occasionally, outsourced activities are carried out using some relatively specialized resources, ones that cannot be transferred easily from one vendor to another. When this happens, a municipality will have difficulty, and perhaps incur substantial costs, in replacing an existing vendor with a new one. For example, finding a new vendor for, say, a waste removal service or a nursery school could be quite difficult, due primarily to a variety of investments that will need to be replicated by a new vendor. A waste removal vendor no doubt has

established efficient routes for its vehicles, has determined how many vehicles it needs on each route due to the average volume of waste to be removed, perhaps has established relationships with certain citizens for specific kinds of waste removal, and so forth. In a nursery school, teachers have learned about children and their needs, have established relationships with parents, and have developed programs that respond to both. In these instances, as well as in many similar ones, the switching costs could be quite high.

By contrast, if a service such as snow removal is outsourced, the switching costs are likely very low. If one vendor does not perform according to the contract, the municipality usually has little difficulty finding a replacement. Indeed, a municipality may have contracts with several vendors to protect it from any sort of "vendor holdup," i.e., the capability of a vendor to increase its price because the municipality has few if any other options.

The three dimensions of risk assessment are illustrated in Figure 1. As this figure indicates, the low-risk cube embodies services (such as a publication department) with a combination of low citizen sensitivity, high competition, and low switching costs. These situations have a high probability of successful outsourcing with only minimal managerial intervention. Similarly, a service such as snow removal might be in the upper left, front corner, where citizen sensitivity is high but where a poorly performing vendor can be replaced easily and quickly. At the opposite end of the spectrum (high citizen sensitivity-low competition-high switching costs) are services for which outsourcing is more risky. Figure 2 provides some additional examples.

FIGURE 1
The Three Dimensions of Risk Assessment
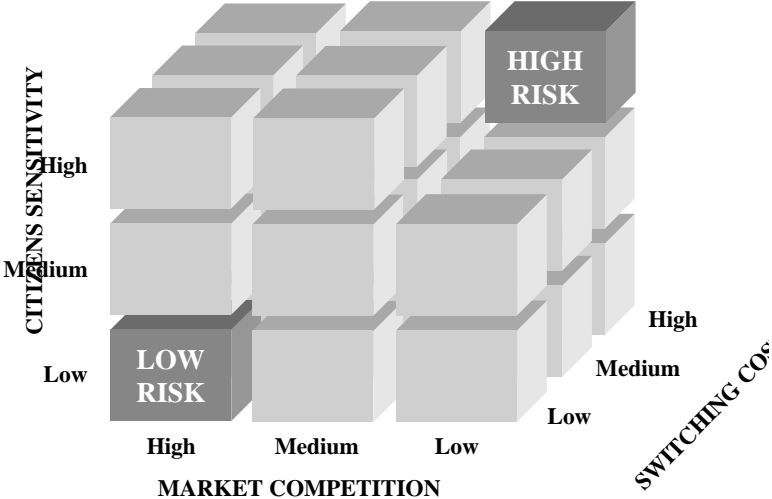
FIGURE 2
Examples of Outsourcing Risk Differences
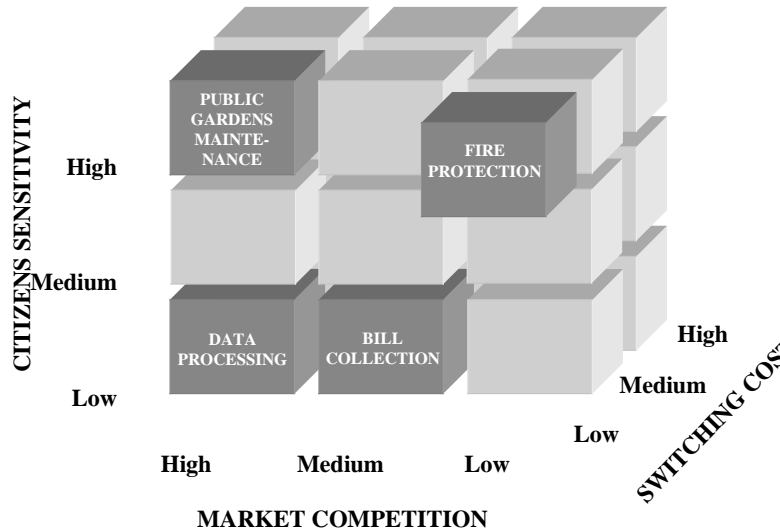
A particularly vivid example of the perils of high-risk outsourcing was illustrated some years ago in the United States. The Commonwealth of Massachusetts had outsourced its Medicaid Management Information System, a system that mailed several hundred thousand checks each month to the state's indigent citizens. Citizen sensitivity was high, market competition was low (there were almost no vendors other than the one chosen that had computer systems of sufficient size and sophistication to undertake the various activities, only one of which was sending out checks), and, due to the need to transfer software (or rewrite code in some instances), plus the difficulty of moving data files from one vendor to the next and performing the necessary audits, the switching costs were high. When the vendor went bankrupt, several hundred thousand Medicaid recipients learned quite painfully what "high risk" really meant.

A Conceptual Framework for Managing High Risk Outsourcing

It is important to recognize that, even though a service lies in the high-risk area of Figure 1, outsourcing it may still have considerable potential for improving the cost-effectiveness of a municipality's operations. Thus, a municipality doesn't necessarily need to avoid outsourcing high-risk services; rather, it must identify those aspects of the relationship that need to be carefully managed to assure high quality and cost-effective vendor performance.

Our research suggests that three elements are important to the successful management of high-risk outsourcing: performance measurement, ongoing communication and coordination, and linkages to the municipality's management control process. As we discuss below, a municipality must pay careful attention to all three if it is to have a successful experience with high-risk outsourcing.

Performance Measurement. With high-risk outsourcing, simply monitoring a contract is not enough; monitoring must be supplemented with a variety of other activities. Kettner and Martin (1985) have argued that these activities include (a) periodically reviewing progress toward the accomplishment of contractual terms, (b) identifying areas that require corrective action, and (c) checking to be certain that the corrective actions were effective.

In addition, as it enters into contracts that move it closer to the high-risk area of Figure 1, a municipality must undertake a variety of activities to ensure not only that the vendor is cost-effective, but responsive to citizen needs. Responsiveness includes taking steps to ensure that problems are resolved quickly, and focusing on distributional equity, i.e., assuring that the service is fairly distributed throughout the municipality's neighborhoods and economic groups (Marlin, 1984).

Finally, as its outsourcing moves northeast and toward the rear in Figure 1, a municipality must be certain to focus on exactly what services it is purchasing from a vendor, and especially on the distinction between inputs and outputs. With traditional *regulatory contracting*, a municipality specifies the activities (or inputs) in detail. By contrast, with *performance contracting,* it simply states the outputs the vendor is to provide, and allows the vendor to determine the most appropriate mix and quantity of inputs.

Building on the various definitions in practice, Martin (1999) defined a performance-based contract as one that "focuses on the *outputs*, *quality* and *outcomes* of service provision, and ties at least a portion of a contractor's payment, as well as any contract extension or renewal, to their achievement" (page 8, emphasis in original).

Persuaded by a real possibility of improvements in outsourced services, this shift in focus from inputs to outputs received growing attention in the literature. It took place in the U.K. in the early 1990s, in response to criticism of Compulsory Competitive Tendering (Walsh and Davis,1993; Department of the Environment,1993), and migrated to the U.S. several years later (Gordon, 2001). More recently, the U.S. General Accounting Office (2002) and Zacchea, (2003) have argued that a performance-based contract must focus on: (a) requirements in terms of

results rather than production methods, (b) clear definitions of performance measurement methods and goals, (c) descriptions of how the contractor's performance will be evaluated in a quality assurance plan, and (d) positive and negative incentives based on key results.

With a shift to performance contracting, a municipality must be careful to define output in operational terms. In this regard, Anthony and Young's (2003) distinction among three different types of output measures—social indicators, result measures and process measures—can be instructive (see also Hatry [1999], De Bruijn [2002], Poister [2003]). A *social indicator* is a broad measure of output that reflects changes in societal conditions. Typical examples of social indicators are the crime rate, the percentage of effluents in the air, and clean and safe streets. Similarly, measures such as increases in health status, education, and housing conditions also reflect improvements in societal conditions.

In general, a social indicator is affected by both external forces and the activities of many different organizations, not by just a single vendor. As such, they are useful to a municipality's senior managers and elected officials for strategic planning, but are not especially helpful for vendor monitoring.

By contrast, *result measures* express output in terms that are related to an organization's objectives. They measure the services provided to customers/citizens and are a direct result of the activities of a municipality department or the vendor to which the department has outsourced an activity. Typical examples are number of passengers using an urban transport service, amount and quality of street cleaning, tons (or metric tons) of waste collected, and gallons (or kiloliters) of water distributed.
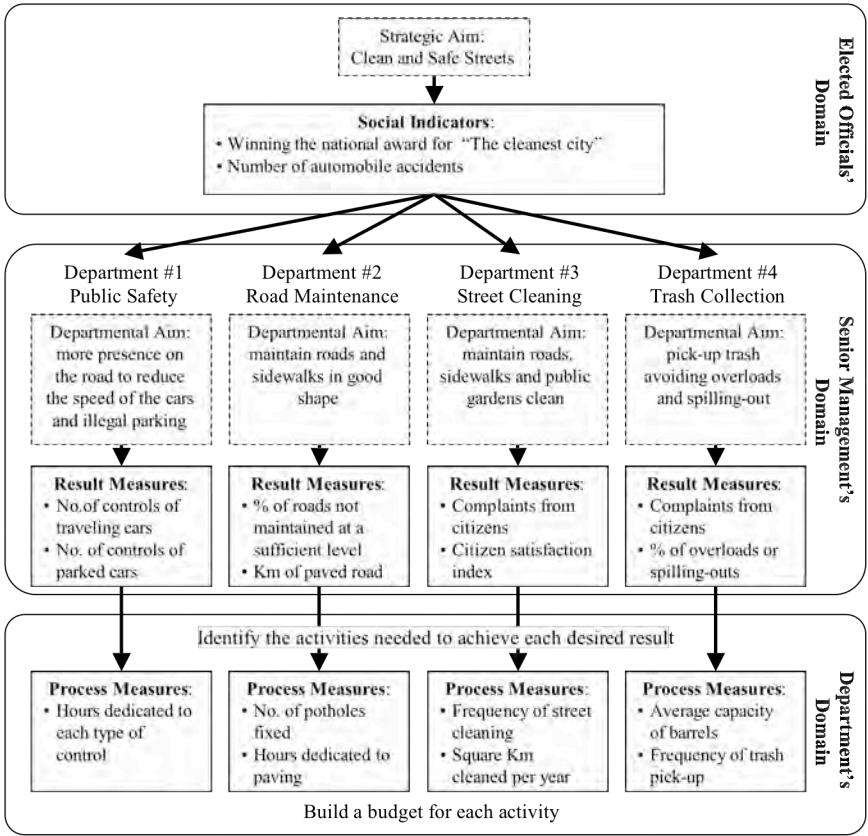
Finally, *process measures* refer to activities that are the department's or vendor's means to accomplish the results. Examples include the number of maintenance interventions, the number of documents processed in an office, the number of hours dedicated to public health inspections, the number of applications reviewed in a nursery school, and so forth.

Prior to any outsourcing decision, a municipality's senior managers must undertake the very difficult analysis of how each department's results will contribute to an improvement in the municipality's social indicators as defined by elected officials. An example of how this latter activity might be done for the social indicator of clean and safe streets is shown in Figure 3. As this figure indicates, achieving this social indicator requires a coordinated effort among several different departments. The municipality's senior managers must determine how

the services of each department contribute to the social indicator. They then must determine the desired results from each department, and develop a measure for each.
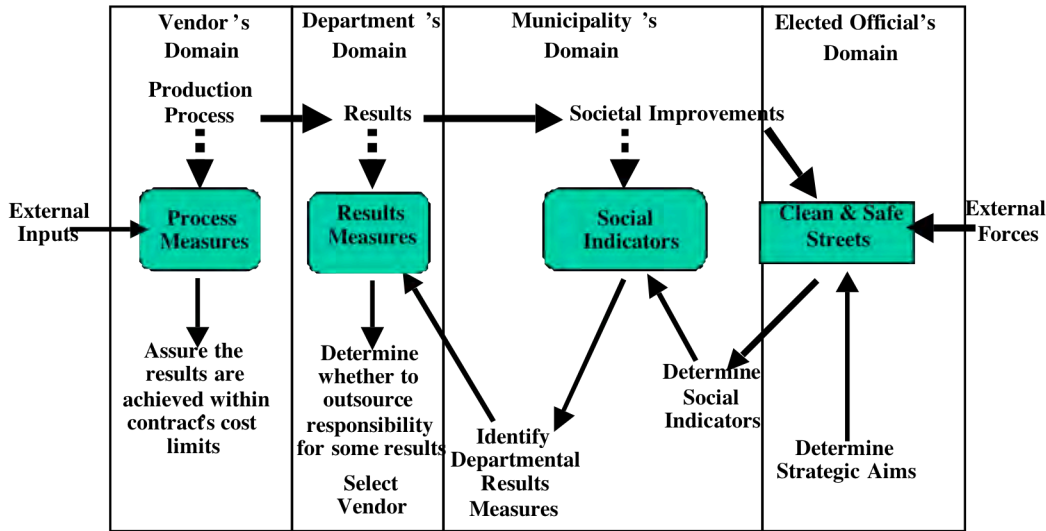
FIGURE 3
Linking the Three Types of Measures in a Municipality: An Example

Strategic Aim:
Clean and Safe Streets

Social Indicators:
- Winning the national award for "The cleanest city"
- Number of automobile accidents

Elected Officials' Domain

Department #1 Public Safety	Department #2 Road Maintenance	Department #3 Street Cleaning	Department #4 Trash Collection
Departmental Aim: more presence on the road to reduce the speed of the cars and illegal parking	Departmental Aim: maintain roads and sidewalks in good shape	Departmental Aim: maintain roads, sidewalks and public gardens clean	Departmental Aim: pick-up trash avoiding overloads and spilling-out
Result Measures: • No.of controls of traveling cars • No. of controls of parked cars	**Result Measures**: • % of roads not maintained at a sufficient level • Km of paved road	**Result Measures**: • Complaints from citizens • Citizen satisfaction index	**Result Measures**: • Complaints from citizens • % of overloads or spilling-outs

Senior Management's Domain

Identify the activities needed to achieve each desired result

Process Measures: • Hours dedicated to each type of control	**Process Measures**: • No. of potholes fixed • Hours dedicated to paving	**Process Measures**: • Frequency of street cleaning • Square Km cleaned per year	**Process Measures**: • Average capacity of barrels • Frequency of trash pick-up

Build a budget for each activity

Department's Domain

Once the results and their measures have been developed, each department can then determine the activities it needs to undertake to achieve the desired results, and build its budget accordingly. In some instances, the department will decide to outsource these activities, and in others it will provide them itself.

It is in the context of a department's decision to outsource that the distinction between performance and regulatory contracting surfaces. As Figure 4 indicates, when a department decides to outsource an activity, it has shifted the responsibility for a portion of its "production process" to the vendor. Hence, under performance contracting, the department no longer is concerned with process measures, but rather with the vendor's ability to achieve the results for which the department is responsible at a lower cost than the department would have incurred if it has undertaken the production process itself.

FIGURE 4
The Impact of Performance Contracting

Vendor's Domain	Department's Domain	Municipality's Domain	Elected Official's Domain
Production Process	Results	Societal Improvements	
External Inputs → Process Measures	Results Measures	Social Indicators	Clean & Safe Streets ← External Forces
Assure the results are achieved within contract's cost limits	Determine whether to outsource responsibility for some results	Identify Departmental Results Measures	Determine Social Indicators
	Select Vendor		Determine Strategic Aims

To illustrate, consider a decision by the Department of Public Safety to outsource traffic light maintenance. Under performance contracting, the department is unconcerned with how often the vendor inspects each plant or how efficient employees are in conducting the inspections (both of which are process measures). Instead, the department focuses on such results measures as the percentage of operating traffic lights, or the amount of time needed to restore a broken light. In effect, the department is purchasing "functioning traffic lights" not "inspections."

At the same time, the department needs a model that links functioning traffic lights to some of the results for which it is responsible, such as, say, a reduction in traffic fatalities, fewer accidents at intersections with traffic lights, a smoother flow of traffic during rush hours and hence a reduction in fuel use. Of course, some of these results are affected by the activities of another department, such as street maintenance, or by external conditions, such as weather, driving habits, use of seat belts and airbags in automobiles, and so forth. Nevertheless, all of these elements factor into the department's, and hence the municipality's, thinking about improving its social indicator of clean and safe streets. The department (or vendor) responsible for traffic light maintenance plays only a small part in this bigger picture.

Clearly, not all types of result measures can be in a contract. For example, "cleanliness" of streets is difficult to define and measure. Moreover, even if defined in a reasonably clear way, performance can be influenced by "inspection bias." For example, the English Code of Practice on Litter and Refuse defines four different cleanliness grades (A-B-C-D), using pictures (see www.encams.org). Even so, this measure remains somewhat subjective, and also can be influenced by inspection bias. Nevertheless, as a performance measure, it is preferable to, say, the frequency of street cleaning, which says nothing about results.

Street cleanliness is relatively easy, however. Defining and measuring, say, the quality of an outsourced social service, or a youth program is much more difficult. To address this dilemma, some municipalities use surrogate measures, such as citizen complaints about cleanliness, number of people who request assistance, length of assistance period, consumer satisfaction surveys, and so forth.

Finally, it is possible that performance contracting can lead to a rigid focus on the results measures specified in the contract, rather than creative thinking about how the quality and/or quantity of services might be improved at no additional cost (Behn & Kant, 1999; Domberger, 1998). To encourage its vendors to focus on continuous quality improvement (CQI), a municipality must address the nature of its ongoing communication and coordination activities with them.

Ongoing Communication and Coordination

McNeil (1974; 1978; 1985) has identified three categories of contracts: classic, neoclassic and relational. Under the classic approach, the purchaser attempts to identify and provide for all possible contingencies, and the contract is limited to its formal aspects. If the vendor does not comply with those aspects, the resulting consequences are known in advance. Therefore, enforcement is largely mechanical.

The neoclassic approach recognizes that classic contracts cannot always be prepared because the definition of all future contingencies is either impossible or too expensive, especially for multi-year contracts. These contracts tend to have gaps that can be filled by specific procedures to solve disputes, such as arbitration.

Finally, with a relational contract, the focus is on a working relationship that has been developed over time. Although there may be a formal agreement, it is less important than the relationship itself, and the contract period typically is quite long. This approach is particularly useful in situations where the task to be completed is complex and/or evolving.

Viewed somewhat differently, a classic contract is characterized by negotiations that can be adversarial at times, and where there is limited trust, thereby creating the possibility of opportunistic behavior on the part of the vendor. At the other extreme, a relational contract is characterized by mutual trust, personal ties, cooperation, and a close working relationship. The full spectrum is shown in Figure 5.

FIGURE 5
Range of Possible Contractual Relationships
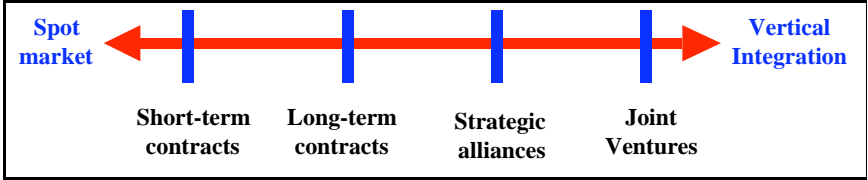
To assess the issue of a municipality's relationship with a vendor, consider the printing example discussed earlier. In a "spot-market" relationship, a municipality might wish to make a one-time purchase of, say, 5,000 copies of a brochure about a youth program. It would ask several local printing companies for bids and choose the lowest-priced one, knowing that the quality would be acceptable and the delivery on time. Alternatively, the municipality might have some short-term contracts with several local printing companies to meet needs such as this. If one company were unavailable, a request to another could be made quite easily.

Another possibility is a long-term contract with a single printing company, with the idea that the company would be devoted exclusively to the municipality's printing needs. This sort of contract might evolve

into a strategic alliance if the municipality had some uncertain printing needs in which the vendor agreed to provide services as required without knowing in advance exactly what kinds of requests it would receive. The contract might be a loosely worded one, calling for, say, quarterly discussions and a "settling up" of balances due.

Going even further, a joint venture might take place between a municipality and a printing company where the company becomes a partner with the municipality and perhaps is guaranteed a certain percentage of the profit each year. Finally, vertical integration would exist if the municipality had an in-house department that met all of its printing needs, with no reliance on outside vendors.

There is some evidence to indicate that a shift toward the right in Table 1 is taking place in many municipalities. For example, because of market imperfections in some locales, many contracts tend to be characterized by mutual dependence, a convergence of interests, and an erosion of boundaries, all of which lead toward a more tightly coupled relationship (Kettl, 1993). Indeed, in contexts such as Italy, where municipalities are legally required to outsource, there is evidence to suggest that a contract cannot substitute for the informal-hierarchical relationships that exist among governments and public-owned enterprises (Massarutto & Tabacco, 2002). In these instances, the relationship between a municipality and its vendor has a much more important role than the contract itself.

Moving from this conceptual view to a more practical one, Darwin et al. (2000) have developed a methodology that can assist a municipality's contract manager to determine whether the relationship with a vendor is transactional or relational. We used a slightly adapted version of this methodology (shown in Table 1) to help us think about the *non-*contractual dimensions of a municipality's relationship with its vendors, especially with regard to ongoing communication and coordination.

Ongoing communication and cooperation are important in most high-risk outsourcing arrangements for four reasons. First, many such contracts are open-ended, and therefore particular specifications—e.g. schedules, resolution of unexpected events, and service extensions— need to be addressed in formal and informal agreements that frequently extend beyond the specific terms of the contract. Second, even if the contract specifies that, say, citizen complaints are to be sent directly to the vendor, some citizens contact the municipality directly, and their complaints need be forwarded to the vendor for action. Third, communication between the municipality and the vendor is directly related to monitoring activities. Finally, cooperation can address any ambiguities or missing elements in the contract, thereby providing the

municipality with an opportunity to improve the production processes so as to meet citizen needs more adequately.

TABLE 1
Dimensions of Contractual Relationships

Dimensions	Purely Transactional	Highly Relational
Communication	Limited and formal	Extensive, and both formal and informal
Measurement	Everything in monetary terms	Many aspects difficult to measure; Parties do not measure them
Beginning/End	Clearly defined	Sometimes not defined; If defined, gradual
Initial planning	Complete and specific	Limited at the beginning
Bargaining	Little or none during the contract	Extended mutual planning and creativity
Bindingness	Partners are totally bound	The agreement is tentative
Cooperation	Almost none after start of contract	Success depends on further cooperation in performance planning
Assignment of benefits/burdens	Each assigned to only one party	Undivided sharing of both benefits and burdens
Specificity of rules/rights	Based on agreement, and usually measured in monetary terms	Non-specific and non-measurable
Altruism	None is expected or occurs	A significant amounts is expected
Problems expected	None expected. If occur, governed by specific rights	Anticipated and dealt with by cooperation

Source: Adapted from Darwin *et al.* (2000, p. 41)

More generally, communication and coordination between the municipality and a vendor can help to resolve problems that could cause citizen dissatisfaction. While routine problems can be dealt with by daily contacts (phone calls or E-mails, for example), structural problems require something more formal, such as meetings of a joint commission or extended mutual planning. Indeed, without a mechanism to deal with

structural problems, a municipality can have considerable difficulties in managing a high-risk contract. In this regard, managing communication and coordination with a vendor is analogous to managing the kind of conflict that Lawrence and Lorsch (1967) observed some 40 years ago in their research in for-profit companies.

Linkages to the Municipality's Management Control Process

One of the most important aspects of our conceptual framework lies in the mantra "delegation is not desertion." More specifically, outsourcing a service does not mean that it then can be excluded from a municipality's ongoing process of programming, budgeting, measuring and reporting, and evaluating. On the contrary, the municipality's management control process needs to be expanded to include the vendor. For example, some programming decisions, such as the removal of recyclable waste, or the synchronization of traffic lights along a major artery, may involve the vendor. Similarly, the budgeting phase of the municipality's management control process must include the vendor's contracted fees (some of which may be on a per unit basis, rather than fixed); otherwise the municipality's budget will be incomplete.

Perhaps most importantly, the various results measures for the outsourced services need to be an integral part of the measurement and reporting phase of the management control process. As a consequence, the measurement and reporting phase must focus not only on the department within the municipality charged with managing the vendor, but on the results being produced by the vendor. Otherwise, the municipality's senior management will have an incomplete view of the department's performance.

Finally, recognizing that outsourcing is a matter of trade-off choices, and that the environment in which these choices are made is constantly evolving, a municipality needs to undertake a periodic evaluation of the outsourced service. In part, this is because even the best-designed set of results measures may fail to indicate whether the citizenry needs or wants services beyond those it currently is receiving. Also, for any number of reasons, an outsourced activity may have moved from one cube in Figure 1 to another, and this might call for a change in the municipality's outsourcing strategy. Or technology may have changed, such that it would be more beneficial for the municipality to shift from outsourcing to in-house service provision. Finally, it is possible that another vendor, working in another municipality, has developed some considerable expertise in the outsourced activity, such that a change in vendors would improve the quality of the service, lower its cost, or both.

In general, these sorts of problems and/or opportunities will not become apparent during day-to-day operations, or even during the annual budgeting phase of the management control process. Municipal managers have much on their minds and many demands to meet. For perfectly understandable reasons, they frequently are unaware of the sorts of changes that might affect the economics of an outsourcing decision. Ordinarily, only an in-depth evaluation can bring new opportunities, or as-yet-unseen problems, to light.

METHODS

We examined the above three issues by undertaking in-depth case studies of three Italian municipalities. Clearly, an important methodological question that underlies our research concerns the utility of conclusions drawn from field research in just three organizations. Obviously, those who consider only statistically significant comparisons of large data banks to be "scientifically valid" will look askance at the conclusion drawn from a sample of three. However, while statistically verifiable information has made important contributions to society's understanding of public sector management, a quantitative methodology cannot capture the complexity and richness of something like the management of an outsourced service.

In selecting a field study methodology, we were aware that it would be incorrect to suggest that every municipality's vendor selection and management activities are like those discussed in our cases. Indeed, as most researchers in the field of public administration know, there is no such thing as a "typical" municipality. Every city or town has a unique configuration, based on its history, location, political and governance structure, citizenry needs, and so on. Since *all* municipalities are ultimately anomalous, one must be careful about drawing universal conclusions from almost any sample, no matter how large.

It is thus important to stress that we are not attempting to generalize about all municipalities. Rather, we believe that some illuminating observations drawn from only a few municipalities can suggest some highly useful conclusions about some important issues in vendor selection and outsourcing management. Indeed, if the information obtained from our research can lead to some concepts that "resonate" with municipality managers, as we believe will be the case, then the conclusions we draw have validity for improved outsourcing in a wide variety of municipalities.

The Case Studies

The Italian municipalities in our field study were outsourcing waste collection. Two of them (A and B) also were outsourcing waste disposal to the same vendor (Municipality C was outsourcing it to a different vendor). In addition, all three outsourcing contracts included many additional services (known, in Italy, as "igiene ambientale" services) that comprised a variety of integrated activities.

The three municipalities were medium sized (20 to 30 thousand inhabitants), located in the Emilia Romagna region. At the outset of the project, there appeared to be different levels of effectiveness among the different vendors' waste collection and disposal services (which turned out to be true), which we saw as a methodological strength. That is, the differences allowed us to think about potential linkages between the elements of our framework and a vendor's effectiveness.

The cases were chosen with the goal of seeing if different results could be explained by the same conceptual framework, using Yin's (1995) theoretical replication principle. To ensure construct validity, we used multiple data sources and methods, and followed a "triangulation technique" (Stake, 2000). In each municipality, we collected primary data using semi-structured interviews with the contract manager and several other individuals involved with the outsourced services, such as politicians, controllers, and public relation managers. We also analyzed several sources of secondary data: contracts, citizen charters, municipality refuse regulations, vendor reports, management control system documents (plans, programs, budget and reports at different levels concerning outsourced activities), correspondence between the municipalities and the vendors, and other formal and informal documents. Each case was submitted to the contract manager for validation.

As Table 2 indicates, although all were medium-sized municipalities, there were a variety of differences among them in terms of their area, population density, location, metric tons of waste collected, and length of the contractual relationship. In addition, as discussed below, the three displayed various differences in how they managed their vendors.

TABLE 2
Main Characteristics of the Three Municipalities

Main Characteristics	Municipality		
	A	B	C
Population	30,000	25,800	22,000
Area (square km.)	45	82	188
Population density (inhabitants per square km.)	659	314	117
Type of community	Residential & Industrial	Residential & Touristic	Residential & Touristic
Nature of community	Metropolitan	Coastal	Coastal
Waste collected (metric tons)	8,000	37,000	37,000
Outsourced activities	Waste collection & disposal	Waste collection & disposal	Waste collection
Length of contractual relationship	7 years	3 years	12 years

Municipality A

Municipality A's contract contained 40 different performance indicators—22 result measures and 18 process measures. The contract manager monitored the vendor's activity using two different approaches: receiving complaints, and making inspections. Although the vendor had its own call center for complaints, most citizen complaints went directly to the contract manager or the public relation office of the municipality (which then forwarded them to the contract manager).

An inspector examined several important aspects of the vendor's performance: level of cleanliness of the streets, refuse collection operations, overflowing glass and paper containers, and facility maintenance. This activity took place three hours a day, six days a week, for a total of 21 hours per square kilometer a year. About half of the performance indicators in the contract were monitored (those considered most important by the contract manager), divided about evenly between result and process measures.

Negative inspection findings and citizen complaints were forwarded to the vendor on a daily basis, and the vendor notified the contract manager when each problem was resolved. Deficiencies were divided into two groups. "Spot" deficiencies were minor problems, such as refuse overflowing from containers, litter left along streets, and the like; they usually were remedied quickly. "Structural" deficiencies arose when the same problems occurred repeatedly and needed to be solved more systemically. These deficiencies were discussed during meetings of a joint commission (composed of the contract manager, a vendor

representative, and a third party). This commission met bimonthly to discuss problems that had arisen and approaches to their resolution. The commission also considered potential new services and/or procedures, and levied penalties for non-compliance.

Municipality A's management control process monitored only two performance indicators: percentage of recyclables to total waste and purity of recyclables. These two indicators—which lie between results and process measures—were used by senior managers and elected officials to monitor the strategic aims of the service. All other aspects, such as street cleanliness, availability of solid waste and recyclables containers, the level of facility maintenance, and the like, were delegated to the contract manager.

Neither the municipality nor the vendor collected output indicators. Therefore the municipality had no concrete way to know if the service satisfied citizen needs. However, it was possible to assess citizen satisfaction using the number of complaints (Poister, 2003 or De Bruijn, 2002), and these had dropped considerably during the three years prior to the research project. In part, the decline came about because the contract was renewed, meaning that the vendor could draw on the knowledge and experience gained during the previous contract. In addition, and perhaps more importantly, the joint commission promoted cooperation between the municipality and the vendor to meet citizen needs.

Municipality B

At the time of the research project, Municipality B's contract was three years old, and was almost identical to a contract with the largest municipality in the area (which was served by the same vendor). The contract contained 75 performance indicators, of which about 80 percent were results indicators. However, only a third of the indicators actually were monitored. According to Municipality B's contract manager, this was because he did not have sufficient time to monitor all the measures contained in contract. Instead, he focused on what he considered to be important to meet citizen requirements, such as observance of street cleaning hours, and timeliness of removing unlawful citizen dumping.

Shortly prior to the research project, the office that managed the contract (and many other tasks) had been restructured, and the number of employees had decreased by 30 percent. The result was a drop in hours dedicated to direct inspections, which had declined to about 8 hours per square kilometer a year. Although the contract provided for periodic meetings between the municipality and the vendor, no meetings took place.

Citizen complaints were received directly by the vendor or the municipality. In the latter case, the contract manager classified them into one of three categories. The least serious complaints were communicated to the vendor by phone on a daily basis. More serious complaints were forwarded to the vendor by E-mail. The most serious complaints resulted in a formal letter mailed to the vendor, with a copy to the citizen who had made the complaint. The municipality then followed up, and communicated the resolution to the citizen.

Municipality B's management control process did not consider the outsourced services at all. Services were paid directly by citizens, such that cost increases resulting from improvements were paid directly by the citizens. Although no citizen satisfaction information was available, recent public meetings had highlighted some deficiencies (not known in advance by the contract manager), such as the need for increased street cleaning in some residential zones, and the importance of a higher frequency of trash collection in areas with a high density of restaurants.

Municipality C

After ten years with the same vendor and contract, Municipality C had decided to engage in competitive bidding, which took place about two years prior to the research project. An external consultant group had revised the contract's specifications to include picking up trash from containers along the street, rather than door-to-door. The municipality had selected the same vendor for the new contract, but, because of the change, the vendor had needed to completely reorganize the way it carried out its activities.

The new contract specified the quantity of inputs, activities and procedures that the vendor needed to follow. It contained 41 process indicators and 27 results indicators. Monitoring was based on citizen complaints and inspections. Complaints, which increased considerably in the summer, were divided between regular (similar to the low seriousness in Municipality B) and non-regular (medium and high seriousness in Municipality B). The contract manager (or an assistant) forwarded regular complaints to the vendor, but without a request for feedback. Non-regular complaints, typically were generated by tourists in the summer, and were followed up by the contract manager on a case-by-case basis.

The employee in charge of inspections worked two hours a day, from Monday to Saturday, which translated into 5 hours per square kilometer a year. After each inspection, problems were transmitted to the vendor by a phone call, with no feedback. Because of the extensive area covered by Municipality C, the inspector could not conduct an in-depth review of the

vendor's responses. Nor could he monitor the inputs, activities, or procedures specified in the contract.

The municipality paid a fixed amount for the entire service, which did not cover disposal (provided by another company). Although the previous contract applied penalties, if necessary, the current contract contained no penalty provisions. At the time of the research project, the service was showing critical deficiencies, such as refuse overflowing from containers and unclean streets reported by citizens.

Effectiveness of the Outsourced Services

Due to the lack of benchmarking data on performance, it was not possible to undertake an independent assessment of the effectiveness of the vendor in each municipality. Instead, we ranked the three municipalities in terms of *comparative* levels of effectiveness. We concluded that Municipality A was the most effective. The actual quantitative and qualitative levels of the service were sufficient to satisfy citizens' needs, complaints had fallen during the last three years, and reported problems were usually solved quickly.

Municipality B was second. The service did not present serious deficiencies but many requests for modifications arose during the public meetings, suggesting that the service could have been improved. Moreover, the absence of information on citizen satisfaction meant that the contract manager had little basis other than public meetings to address citizen concerns.

Municipality C was third. The contract was more regulatory than performance-based, and was structured in a way that inhibited the municipality's ability to measure the vendor's effectiveness in meeting citizen needs. An absence of vendor feedback meant that the contract manager did not know if problems were being addressed satisfactorily. Moreover, at the time of our research, the service was showing some very clear deficiencies.

THE THREE MUNICIPALITIES AND
THE CONCEPTUAL FRAMEWORK

Although we did not attempt to develop a methodology that would place each municipality in a precise "risk cube" in Table 3, we nevertheless were able to assess the rough location of each in that framework. For example, because the municipalities were outsourcing multiple services that affected citizens directly, citizen sensitivity was high in all three sites. Market competition was very low for Municipalities A and B (where there was only one vendor that could

provided the multiple and integrated services), and medium for Municipality C (where one or two potential alternative vendors existed). Switching costs were very high for Municipalities A and B (since there was nowhere to switch), and medium for Municipality C. We thus concluded that Municipalities A and B were very close to the upper-right-back corner of Figure 3, whereas Municipality C was closer to the middle of the cube.

In short, Municipalities A and B were engaged in extremely high-risk outsourcing, and Municipality C in medium- to high-risk outsourcing. Moreover, as is clear from the case studies, the three took quite different approaches to managing their vendors. These differences are summarized in Table 3, which also contains our assessment of the effectiveness of its outsourced service, and the characteristics of the municipality's approach to managing its vendor. As this table highlights, there were marked contrasts in terms of performance measurement, ongoing communication and coordination, and linkages to the management control process.

Performance Measurement

Municipalities A and B approximated performance-based contracts in that they had many results measures. [2] Municipality C, by contrast, was more regulatory, with more process measures and rules concerning the production process (e.g., number of vehicles and employees for each activity, number of container-washing operations, collection routes and methods). Moreover, successful operational performance appeared to be linked to monitoring result measures rather than process measures, and dedicating sufficient time (hours per square kilometer per year) to inspections (21 in Municipality A, 8 in Municipality B, and 5 in Municipality C).

More generally, high quality performance measurement appeared to rely on three factors: (a) follow-up of complaints, (b) knowledge of the critical factors of the service (e.g. waste collection in certain areas during busy periods) by the contract manager, and (c) presence of monitoring indicators within the contract.

Municipality A incorporated factors (a), (b) and some of (c). The contract manager dedicated a significant amount of time to direct inspections, and he learned daily about both "structural" and "routine" problems, as well as any requests for container maintenance. On the other hand, Municipality B focused on activities (a) and (b) only, and had a somewhat lower level of ongoing operational performance measurement. Municipality C, was somewhat random in its focus, and had only minimal performance measurement.

TABLE 3
Risk, Performance, and Vendor Management Activities in the Three Municipalities

	Municipality		
	A	B	C
Risk	High	High	Moderate
Performance (Effectiveness)	Best	Next Best	Worst
Performance Measurement	Key items	Key items	Key items
Kind of Measures Used	Many Result Measures	Many Result Measures	More Process Measures
Hours Dedicated to Inspections	Many	Few	Few
Follow-up of Complaints	All Complaints	All Complaints	Most Serious Complaints Only
Knowledge of the Critical Factors by the Contract Manager	Thorough	Thorough	Superficial
Presence of Monitoring Indicators within the Contract	Half of the Indicators in the Contract	One Third of the Indicators in the Contract	Very Few
Discussion About "Spot" Deficiencies and Their Solutions	Yes, on a Daily Basis	Yes, on a Daily Basis	None
Discussion About "Structural" Deficiencies and their Solutions	Yes, Bimonthly (Joint Commission)	Seldom (Public Meeting)	Very infrequent (Political Involvement)
Linkage to the Management Control System	Some Outcome Indicators and Process Measures	None	None

Ongoing Communication and Coordination

Ongoing communication and cooperation differed considerably across the three sites. In Municipality A, the contract manager contacted the vendor daily to forward complaints and discuss the results of his office's monitoring activities. This was always followed by timely feedback from the vendor. In addition, a joint commission had been

established and met bimonthly to discuss problems that had arisen and approaches to their resolution. It also addressed potential new services and/or procedures, and penalties for non-compliance.

In Municipality B, there was daily contact and the vendor gave timely feedback. However, no joint commission had been established, even though it was an element of the contract. Instead, public meetings took place involving the municipality, the vendor, and the citizenry; thus, they were used to update contract specifications.

In Municipality C, daily contacts were not followed by feedback from the vendor, nor did the contract manager request feedback. No joint commission had been established, and no public meetings took place. When the service displayed some structural deficiencies, some of the municipality's politicians became involved, and subsequently contacted and followed-up with the vendor to try to determine if the problems had been resolved.

More generally, communication and cooperation appeared strongest when there were (a) daily contacts for the resolution of service inefficiencies with feedback from the vendor, (b) meetings of a joint commission, and (c) application, as needed, of contractual penalties for non-performance.

Linkage to the Management Control Process

Linkages to the municipality's management control process included quality measures connected to the outsourced services, and process measures concerning the contract manager's monitoring activities (as distinct from the vendor's process measures). However, only in Municipality A had senior management identified some outcome indicators and process measures concerning the contract manager's monitoring activities. Indeed, in Municipality A, unlike Municipalities B and C, senior managers did not need to become involved in day-to-day contract management—they had sufficient information from the management control process to meet their managerial needs. The only missing ingredient was quality, for which the contract manager updated them on a regular basis.

As noted earlier, it is difficult to include both quality measures and measures of social indicators in a contract. Nevertheless, both are part of a municipality's responsibility. Thus, inclusion of these measures in a municipality's management control process is essential. There are also process measures connected to the monitoring activities of the municipality's contract manager that can be included in the municipality's management control process, but only Municipality A had

developed an indicator —number of inspections—that was related to the contract manager's monitoring activities.

CONCLUSIONS

The information from our literature review, juxtaposed with the data from our three case studies, suggests that managing high-risk outsourcing requires a municipality to focus on operational performance measurement, engage in ongoing communication and cooperation with the vendor, and develop linkages to its management control process. More generally, as Figure 5 indicates, the effectiveness of a high-risk outsourcing contract is highest when there are (a) a set of multiple performance measures that focus mainly on results, (b) a well-established process for communication and cooperation that fills the inevitable gaps in any high-risk contract, and (c) a management control process the includes quality measures, outcome measures and process measures concerning both the vendor's results and the contract manager's activities. All three existed in Municipality A, and none were present in Municipality C. Indeed, the absence of these elements in Municipality C had led to a situation in which the vendor's effectiveness had dropped to a point where it was necessary for elected officials to engage in emergency problem solving due to vociferous complaints by the citizenry. In effect, Municipality C was attempting to manage a high risk outsourcing activity as though the service could be purchased on the spot market. Nothing could be more misguided.

FIGURE 5
The Three Key Processes of Managing Outsourced Services
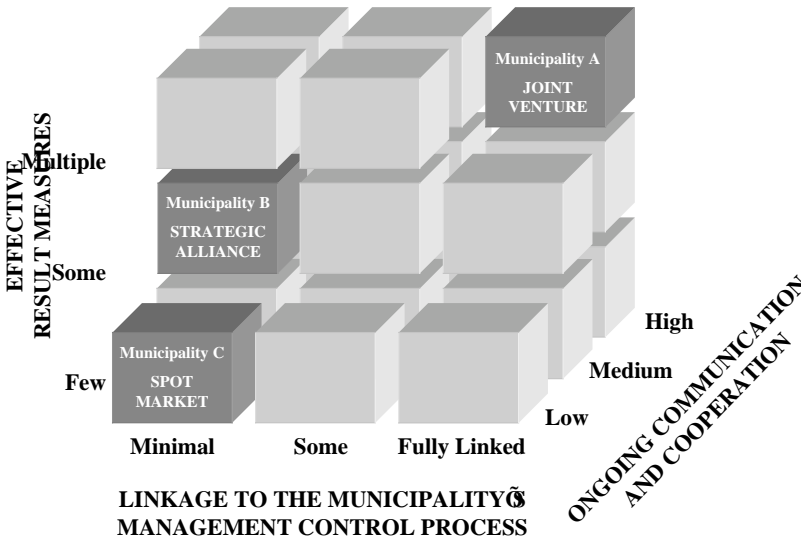
In short, when a municipality engages in high-risk outsourcing and wishes to assure its citizens that the savings realized from the outsourced activity are not matched by a reduction in service quality and features, it must begin to develop an appropriate set of outsourcing management activities. The existing literature, coupled with our field studies, suggests that the three key activities are operational performance measurement, ongoing communication and cooperation, and linkages to the management control process. Given that many outsourcing arrangements are of a high-risk nature, a municipality must focus on these activities if it wishes to assure its citizens of effective services at a reasonable cost.

NOTES

1. These examples assess the risk level of outsourced municipal services in the United States. Since the levels of the three dimensions can vary depending on the local context, the examples will not necessarily be the same for other countries

2. Precise performance measurement was not possible due to the lack of two of the four elements identified by Zacchea (2003) and the U.S. General Accounting Office (2002): linkages to the quality assurance plan, and a set of positive and negative incentives based on key results.

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