CHAPTER -II
CONTRACTING OUT: A THEORETICAL FRAMEWORK

Human beings require immense goods and services. The huge goods and services can be sorted and categorized according to two characteristics, exclusion and consumption. This broad classification determines the very role of state and private institutions in providing goods and services.\footnote{E.S Savas(2001), op.cit., pp.41.} With the expansion of basic civic services and rising expectations of citizens, the role of state has changed from producer to facilitator. Tracing the history of private sector intervention is as old as family. There is long history of privatization since ancient Greece. It has been claimed that the term was first used in 1930’s by the economist in Nazi German Economic policy. Even in Roman republic private individuals and companies performed the majority of services. In recent times Winston’s government privatized the British steel industry and West Germany’s government embarked on large scale privatization. In 1970’s General Pinochet initiated significant privatization in Chile. In 80’s Margaret Thatcher in U.K. and Ronald Regan in U.S.A. led to privatization worldwide.\footnote{http://en.wikipedia.org/wiki/Privatization.}

2.1 STATE TO MARKET: GOVERNMENT FAILURE

In the beginning of 20th century the detrimental effect of various forms of government intervention have become clear. There was loss of confidence in the ability of government intervention. The public sector seemed to be inferior in contrast with dynamic private sector. The government’s failure to provide services leads to attention and stimulated in counter revolution. In the earlier part of market failure in the Paretian framework ignored the problems which were likely to emerge in government interference with imperfect market. Delivery of goods and services through bureaucratic organizations are regarded as large, hierarchical, inefficient and inflexible.

Provision of goods and services over the last three decades has been disappointing and that had led to economic inefficiency, ineffectiveness in provision of goods and services and rapid growth of public expenditure. These problems have led many
governments to revaluate the possibilities of shifting publicly managed activities in to private sector.

Poor performance of public sector has been realized in both developed and developing countries. In the wake of government failure it led to shift from state to market. The public choice theorist and principal agent theorist depicts that state involvement is ineffective in cost control. As it led to encouragement to waste, over production of unwanted services, increasing monopoly and budget, therefore new right school of thought advocated privatization.

Public choice theorist such as Muller, Tulluck and Buchanan advocates the state failure. The blame against public sector is that it is inefficient and fails to control cost. Main reason of government organizations failure can be attributed to vested interest of politicians, failure of bureaucrats to do the meaningful as desired.

The major forces that have instigated the privatization movement include pragmatic forces which calls for better government and cost effective. Economic forces also played a significant role in propelling privatization movement which is in favour of less dependence on government by making them more relevant to privatization. Philosophical forces also contributed a lot for less government as they perceived threat to democracy. Commercial and populist forces also ignited the spark in movement of privatization which aims at more business opportunities and better society.

### 2.2 CONCEPT OF PRIVATIZATION

Privatization can be defined as any process which reduces the involvement of the state in economic activities of a nation. Privatization in broad sense include green field privatization in which any measure of economic policy which permits the entry of private sector in areas exclusive reserved to public sector, the closure or liquidation of public enterprise, restricting the expansion or diversification of the activity of any

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7 Kieron Walsh (1997), Public Services and Market Mechanism: Competition, Contracting and New Management, Hampshire, Macmillan.

public enterprise, employing private contractors for supplying various goods and services needed any public enterprise, leasing of public enterprise to private sector, cold privatization, franchise financing, managerial privatization or by sale of share.

2.3 RATIONALE FOR PRIVATIZATION

Privatization includes the many ways in which private sector carries out functions, which were previously undertaken by government. The question arises why government sells or makes arrangements with private sector to produce and supply goods and services. The rationale for privatization can be classified under three heads namely pragmatism, commercial point of view and ideology. Pragmatism had called for privatization due to failure of state owned enterprises in generating adequate surplus. They have become a drain on national treasuries. Despite continuous efforts and amendments the gist of organizational culture remained obsolete. This supported privatization as it offers dynamic solution. Secondly government failed to discharge its role as entrepreneur thus ideological point of view privatization is called forth. The core objectives that advocate its rational encompasses greater efficiency, cost effective in public service, revealing the true and full cost of service provided. Promotion of technological advancements for proper development of capital market, creating the surplus income privatization is considered as disinflationary tool as it eliminates fiscal burden on treasury.

2.4 FORMS OF PRIVATIZATION

Privatization can be carried out in different ways and techniques which broadly include delegation, divestment and displacement. Delegation is positive act by government; it is also known as partial privatization. In delegation the production activity gets transferred to private sector but it requires active involvement by government for proper monitoring. Delegation is carried out by contract, franchise, subsidy or mandate. Divestment literally means shedding an enterprise, function or asset. Generally divestment is taken up in one go. Broadly divestment can be carried out through sales and free transfer. Displacement is passive or indirect process that

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7 S.Vijayalakshmi, op.cit. pp.69.
leads to government being displaced. It has also been called privatization by attrition or stealth. Displacement generally takes place by default when government production of goods and services fails to satisfy the public demand. The second form of displacement is by withdrawal whereas default is unintended or inadvertent; government can engage in deliberate withdrawal or load shedding.  

Table 2.1
Forms of Privatisation

<table>
<thead>
<tr>
<th>Delegation</th>
<th>Contract</th>
<th>For part of service,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Franchise</td>
<td>For total management</td>
</tr>
<tr>
<td></td>
<td>Grant</td>
<td>By concession,</td>
</tr>
<tr>
<td></td>
<td>Voucher</td>
<td>Lease.</td>
</tr>
<tr>
<td>Divestment</td>
<td>Sale</td>
<td>To joint venture, private sector,</td>
</tr>
<tr>
<td></td>
<td>Free Transfer</td>
<td>To the public, employees, and customers.</td>
</tr>
<tr>
<td></td>
<td>Liquidation</td>
<td>To a joint venture, public, employees, to original owner, selected recipients.</td>
</tr>
<tr>
<td>Displacement</td>
<td>Default</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Withdrawal</td>
<td></td>
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<tr>
<td></td>
<td>Deregulation</td>
<td></td>
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</tbody>
</table>

Source: E.S Savas(2001), Privatization and Public Private Partnership

Among all the forms of privatization, the contracting out have emerged as the most discussed and adopted form. In light of this, contracting out is studied in detail as under:

2.5 CONTRACTING OUT

The term contracting out is the most common form of privatization around the globe. It is considered as positive act of the government through delegation. Contracting out refers to the process of using the tendering process to open up service provision to external suppliers i.e. rather than itself employing staff and providing services, the government seeks to have that service provided on its behalf by the lowest price tenderer.  

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9 E.S Savas, op cit, pp.125
10 Richard Denniss, Managing the Transition from Public to Private Sector delivery of Services retrieved on 7th December from http://www.umar.gov.si/fileadmin/user_upload/konference/10/12_dennis.pdf
Literature directly pertinent to contracting is divided into four following categories.

(a) The theory of contracting
(b) Conceptual models of the contracting process
(c) Measuring the performance of how public services are delivered.
(d) Effect of contracting on the cost and quality of public services.

The theory of contracting brings forth many aspects of the process and its outcomes, like the make or buy decision (Cooper 2003; Hirsch 1991; Chamberlin and Jackson 1987; Nemec 2002; Prager 1994), problems allied with agency relationships (Arrow 1985; More 1984; Pratt and Zeckhauser 1986) and the theory of operational costs (Ferris and Graddy 1996; Prager 1994; Hirsch 1991). The literature on contracting models (Kettner and Lawrence 1990; T. Kolderie 1986) personifies information that gives a conceptual basis for two ideal approaches to service contracting. The literature on measuring performance (Engelbeck 2004; P.D. Epstein 1984) is significant because it provides general insight on how local governments evaluate characteristics of service delivery and how performance of particular services might be measured. The literature on effects of contracting on service delivery (Shettely 1998; Engelbeck 2004) deals with research that has inspected the determinants of contractor performance. Contracting public services with private for-profit and non-profit firms is one of the most prevalent types of privatization, mainly at the local government level. Under this scheme, the “government retains responsibility for provision of the service but hires private firms to produce the service” (Nemec 2002).

Contracting can also be explained as a binding agreement in which a public institution hires a private firm or non-profit organization to supply a particular level and quality of public service. According to Savas (1987), since the provision function is retained by the government, contracting represents a traditional approach in terms of an increasing role for the private sector.

The basic concept of contracting rest upon basic decision pertaining to produce or purchase a good or service, which lies with the organization (Prager 1994). It is pertinent for Public organizations to decide whether to produce goods and services internally or to acquire them from external source- contract out public service. Contracting out should be incorporated with the comprehensive policy of the organisation. It requires the active leadership of top management. The ownership and
oversight of the contracting out exercise should therefore rest with the very top of the organisation. Contracting out should not involve a mechanistic consideration rather it should be used as an prospect to assert and asses both the rationale for existing tasks, is these cautions are not taken into consideration, the whole process of contracting out can lead to tensions and resistance within organisations. Consensus of top management and leaders is crucial in preventing, or resolving, these internal impediments to successful contracting out (Puma Policy Brief 1997)\textsuperscript{11}.

To contract out the public good (mostly public service) is the opposite of internalizing the production of a public good, which is very often used in the public sector of transitional countries. To put contracting out in perspective, it is necessary to consider pros and cons of internal and external forms of delivery. Concerning the positive prospects of contracting, the appropriate literature delineates that contracting out may or may not, improve quality of service in a cost-effectiveness manner(Bailey 1999)\textsuperscript{12}.

The motive of Privatization of local public services is to reduce cost in quality effective manner, and the intend at performance based contracting is to hire a private body on the basis of outcomes and performance rather than the procedures or techniques used to deliver goods and services (FCS Group, 2005; Amagoh, 2009) and it has deep roots. Contracting out of local services was firstly suggested by Peter Drucker, the Austrian born management professor and it is considered as pervasive form of privatization (Miranda and Andersen, 1994; Martin, 1999). The wave started in 1980 in Great Britain. Privatization of government activities in the world reached a witnessed record high of $89 billion by 1996 which further rose to $160 billion in 1997\textsuperscript{13}.

In general eminent scholars (Savas, 1987, 2000; Siegel, 1999; Greene, 2002; Dilger, Moffett, and Struyk, 1997; Van Slyke and Hammonds, 2003; Brown and Potoski, 2003a, 2006;) have held that the acquisition of publicly provided services through the market is less costly than if the same services are produced by the government bureaucracy. The foundation for this conclusion is formed by government-failure

\textsuperscript{13} Paul Andrisani and Simon Hakim, Center for Competitive Government, Richard J.Fox School of business and management, Temple University, Retrieved 14\textsuperscript{th} February from astro.temple.edu/~shakim/documents/introprivatization.doc.
bureaucratic model and the apparent pragmatic support for prediction of this theoretical model (Nelson, 1997, pp. 82; Huque, 2005). This evidence suggests that the government could understand cost saving by switching from in-house public services production to alternative service delivery arrangement in term of public services privatization. Thus, contracting out has been considered as solution (Kettl, 1993), in light of this contracting out is professed as the best possible means of creating a new, effective, and more efficient means of service delivery (Ferris and Grady 1986, 332; Savas 2000, 70). Further scholars opines that contracting out at its best, “promotes competence by inspiring private cost saving incentives (Shields 1988, 70) and another reason that favours contracting out are the effortless of measuring contractor’s performance. The easier it is to measure performance, the lesser the danger of the contractors dodging their task.

Scholars are of the opinion that contracting will give way to improved results if there is competition among potential bidders. This has been cited as one of the key rationalization for contracting out (Hodge, 1999; Huque, 2005; Johnston & Seidenstat, 2007; Dijkgraaf & Gradus, 2003). The exercise of contracting out is expected to lower costs of service provision through the discipline of the market and open competition.

While the proponents on the other hand argued about the weak points of contracting, critics are of the view that with cautious attention to keep a vigilant eye on contracting as local government experience has not always been fruitful (Adler, 1999; Sclar, 2000). Local government practice has always implicated a blend of public provision and government contracting (Sonenblum, Kirlin, & Reis 1977). It can enhance quality of service delivery or it can be a counterproductive, depending on the underlying market conditions and operational effectiveness (Brown et al., 2006). Scholar’s regard contracting out can lead to proliferation in corruption and other malpractices (Greene 2002; Fredrickson 2005) and (Moe, 1987), opines that awarding contracts in the absence of competitive bidding can result in spectre of corruption. Another issue of contracting out is viewed as a method of evasion responsibility issues (Gilmour and Jensen 1998, 248). Dicke and Boonyarak feels that (2005, 185), “Downsizing, Devolution, Diffusion, and Empowerment,” all give way to attrition in answerability. These four factors work to wear away the hierarchical, legal, professional, political, moral, and ethical dimensions of accountability (Dicke and Boonyarak 2005, 187-14).
Shetterly (1998, p. 23), holds the view that an imperative element contracting is involved in the process while setting up and maintaining a contractual bond with a private firm, he cautions that this process occurs in phases; pre-solicitation, contractor selection and contract management, the common problems occur when the action and information of the private partner not directly noticeable by the public partner. So moral hazard occurs because behaviour of the private partner is imperfectly controlled. When behaviour imperfectly controlled, it creates a condition where either avoiding in performance duties or inapt actions by the private players unfavourably diverts the goal of public agency. (Arrow 1985, p. 37). More yields, “The principal must weave the interrelated components into a contractual framework that, in lessening the gap informational asymmetries and stimulates the agent to perform as the principal himself would under any conditions that prevails” (More 1984, pp. 756-757). For problems associated with agency relationships, the theory of contracting solves problem of transaction costs. The transaction costs related with contracting are the relationship of these costs should be included in the involvedness of contracting relationship. When contracting for services, governments pay contracting costs which are totally or clearly part of the make or buy decision. Two types of transaction cost “those associated with the contract formation stage; those associated with the contract performance stage” (Hirsch 1991, pp. 56-57). From all above, it is apparent that contracting may, but need not; improve the performance of the public sector. The final yield depends on viabilities of local area and conditions including the capacity of the implementing agency to carry out the process contracting out.

(Public Management Service, 1997) indicates that service necessities should be precise in terms of outcomes or outputs, not inputs. This means specifying what activity is, not how the activity is to be performed. It emphasises that contract design is critical step in the contracting out process. It should be clear, thorough and pre-specified, so that both the parties understand and resolve to work while entering into contract, an inadequately designed contract will result misunderstandings at implementation stage, and more importantly effective vendor monitoring tend to


Best Practice Guidelines for Contracting Out Government Services, op cit.
reduce contractor “shirking”, increase service quality, reduce costs, and consequently improve the returns on contracting (Dean & Kiu, 2002; Paroush & Praeger, 1999; Taylor, 2005; Sclar, 2000). During designing the contract over specification must be avoided for promoting competition as competitive markets are the best way of achieving the benefits of contracting out; once the choice has been made to contract out a service, the organization must then prepare to publicize a request for qualifications, as it helps to ensure that bids that are unrealistic can be thrown out by the governmental entity as invalid if the contractors do not meet qualifications of the agency, for the publicizing government should promote competitive markets by recognizing the importance for development of markets for various segments. Savas highlighted the role of public relations department in harnessing the campaigns for attracting the bidders to making the process of contracting out lucrative for public organizations.

After all proposals have been received, the organization must impartially and rightfully grade bids according to the predefined assessment criteria. Once a contract has been granted, it’s open for negotiation. Within the literature the contract negotiation stage has been believed the most important feature of the entire contracting out process. It is at this stage that the organization will negotiate a contract with the selected proposal. After the contract has been awarded it is significant to adequately review contract compliance and service performance. This may include monthly or quarterly reports by contractors, surprise checks of the files, and financial documentation pertaining to costs. Other monitoring machineries include culture of dialogue with citizens and executing inducement programs (Kelman, 2002; Brown et al., 2003; Huque, 2005). David, 2004; is of view that enhancing competency levels of officials is of utmost importance in making the process goal oriented. The officials must have sound ability to use knowledge to situations like monitoring techniques such as inspections, interim reviews, testing and auditing.

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2.6 THEORETICAL FRAMEWORK FOR PROCESS OF CONTRACTING OUT OF SERVICES

The process of contracting out is catching up around the globe. The importance of an ideal framework is of immense importance to achieve the desired results in terms of low costs and high quality service delivery to the satisfaction of the citizen. Therefore various best practices have been taken into account to have an ideal framework which is as follows:

Secure Top Management Involvement and Encourage Re-Engineering:

The active role of top management is the key for achieving the best results in contracting out as only with the positive participation from top management and leaders can nurture the very concept. The process should not be mechanistic in nature and it must re-evaluate the rationale for prevalent tasks and such re-engineering benefits can be secured through top management. Further top management plays a key role throughout the process especially in preventing and resolving internal obstacles19.

An In-depth Study for Privatizing a Service: Idea of contracting out can be perceived by anyone in an organization, but it can be shaped on pragmatic grounds by leaders. Such a leader can seek help of privatization experts and other officials in similar position who have applied such ideas. Contracting out is in no sense abdication of government’s responsibility or duty but it aims at providing effective services to masses through skilled mechanisms. Before privatizing a service an in-depth study is must to investigate the implications, options and reasons for offering it to private player. It is considered that only those services are contracted out which saves money, increases flexibility, improves quality of services, increase efficiency and innovation, allow policymakers to steer rather than row. There is emergent need to answer pertinent questions to clarify the future of contracting out a particular service. Government agencies owe its responsibility but exercises it by hiring skills of private sector and taking advantage of latter’s strength. Contracting out is not a will of

19 Best practice guidelines for contracting out government services (1997), op.cit.
an organization but many reasons contributes for its adoption. These are given as follows:

(a) Scarce budget problems in government agencies are an indication for privatization, as it will lead to large potential savings for government.

(b) Lack of expertise and modern skills in government employees to deal with works assigned prompt government to hire services of skilled and efficient private experts.

(c) Non availability of facilities, latest equipments and new technology public sector calls for contracting out as private players are well versed with such resources.

(d) Other event that favors privatization is employee strikes in government agencies which not only delay services but also arouse strong public indignation.

Reasons mentioned above helps organization to perceive an idea of contracting out, but there is need for some conditions which must persist, satisfied by a unit of government to privatize. These conditions are as follows:

(a) Leader should be clear about the idea and can take initiative for action.

(b) Strong situations are persisting which requires privatization like scarce funds, resources, inefficiency and shortage of manpower etc.

(c) Contracting out should be lucrative with no compromise in quality of service and with possibility of improvement.

(d) Contracting is politically feasible, taking into consideration the power of the affected employees and other current beneficiaries.

**Selection of Services for Contracting Out:** It is pertinent to demarcate the services which will form part of the contract. Random selection of services will turn contract shabby. The selection criteria should be properly devised after thoroughly understanding various aspects of services like its nature, demand, technique required,
and so on. Before selecting a service an organization should fix some parameters which will evaluate that whether service can be contracted out or not.

On basis of analyzing various studies, it has been found that following points must be adhered to while selecting services for contracting out:

(a) Services with no legal limitations should be selected.

(b) Services for which competitive contracting is feasible with less risk.

(c) Hard core services which requires expertise and skills to be handled

(d) Properly demarcated services should be contracted out for avoiding intermeshing between contractors.

(e) Services which have been contracted elsewhere competitively and successfully

(f) Services which calls for experienced, expert and attentive bidders.

(g) Services important from citizens point of view.

(h) Services which offers large saving opportunities

(e) Services through which contractors performance can be monitored effectively

(f) Services in which government fails to deliver due to lack of resources, inefficient manpower and obsolete technology.

It is of great importance to identify the kind of service required. 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 what is expected and how performance will be evaluated.

**Cultivate Competition:**

Competition encourages better performance. A government agency tries to foster competition among bidders so as to avail quality services and keeps cost intact. But at times, it fails to do so due to shortage of bidders for contract. Corruption in issuing contracts and red tape multiply the problems. Due to maladministration in contracting out process, many bidders refuse to do business with government. To overcome this

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problem, fair, open, honest, and competent treatment of vendors is the best way to encourage potential bidders to compete for the business. It implies that a systematic procedure should be followed to attract bidders for contract and to introduce transparency in such procedures to ensure a fair trial for each and every participant. So in light of ensuring competition among potential bidders it is important to ensure the following points:

(a) Contracts can be geographically scattered or can be divided into small zones.
(b) Details of bids should be well publicized so that a bidder gets full information.
(c) Bidder should be given sufficient time to prepare for bidding procedure.
(d) Excessive reliance on single supplier should be avoided and a large fraction of bidders be entertained.
(e) Bidders performing well should be awarded with timely payments to sustain their interest.
(f) Losing bidders be encouraged to try again next time.
(g) Transparency, fair procedures should be followed in contracting.
(h) Contractors should be refrained from creating their monopoly.
(i) Delays in payments, lengthy procedures of bidding should be improved to attract potential bidders.

Request Impressions of Interest or Qualifications: Sometimes, a government agency is not sure about content of bid document, terms and conditions to be mentioned, about its scope and what will attract bidders. The best way to deal with this situation is to stimulate bidders to prepare request expressions of interest or qualifications. Then, on the basis of response, a meeting can be held in which all potential bidders are invited to discuss on issues in an open and transparent process. This helps agency to collect important information about respondents on the basis of which a systematic bid document can be prepared. Further such information can be applied in preparation of the contract.

Request impression of interest can provide following basis for a contract

(a) An input from various potential bidders helps to prepare a constructive contract documents.

(b) It indicates to restrict competition initially to qualified firms in case complex function is considered for privatization.

(c) It forms the basis of terms and conditions of bid contract.

**Plan the Employee Transition:** During contracting out the organization may come across a problem regarding redundancy of workers. Prior to privatization, an agency uses a large work force to discharge its functions. But contracting out services, arouse fear of unemployment among employees which are officially engaged with the organization. To overcome such problem, it may strive to explore different approaches in this context.

Some of the feasibilities in this regard are as follows:

(a) **Redeployment:** In redeployment, employees are deployed in some other agencies or organization. It can be done through inter-organization transfer or through adjustment.

(b) **Early Retirement:** At times existing employees are offered with voluntary retirement schemes and are paid with heavy compensation followed by some other benefits.

(c) **Hiring By Private Contractors:** In contracts there are some policies requiring contractors to retain employees or to employee some old workers of organization contracting out services. Such a clause should be made part of the contract specifications. An aforementioned approach always gives assurance to redundant employees regarding their future. Issue of redundancy of workers should be dealt with early in the process.

**Prepare Bid Specifications:** Clarity in terms and specifications of a contract holds pivotal importance. Contract specifications must be clear, thorough, accurate and unambiguous. If suppliers are to be encouraged to bid, they must not be confronted with massive and impenetrable documents that require legions of lawyers and accountants to comprehend. A poorly designed bid document creates misunderstanding and contractor fails to respond intelligently. While preparing bid
specifications, feasibility of such rules should be taken into account. Such rules and specifications should be in consonance with pragmatic applicability\textsuperscript{24}.

On basis of analysis of various studies, it has come out that following points must be considered while preparing bid specifications:

(a) Specifications which put unnecessary restrictions should be avoided. Some agencies go in deep about how the contractor should carry out the work, what equipments will be adopted etc.

(b) Services acquaint to legal restrictions should not be embraced in bid documents. As such disputed services are not worthy of being privatized

(c) Hard services which are tangible and visible are easy to consider for bid specifications. As its result can be carved out through proper monitoring

(d) The term of the contract should match with life of service. If life of service is like for 10 years and term is 3 years, then such mismatch will discourage bidder to for the contract.

(e) Terms and policies should be devised by skilled and tech savvy persons. Bid specification is a sensitive aspect of a contract which needs to be handled carefully.

(f) Specifications should provide information about the services to be contracted out, kind of information required from bidders, terms of contract, performance scope, functions involved in services etc.

(g) Cost involved in the bidding should be well defined and be measured by taking into all criteria like inputs costs, market rates and returns.

(h) At times, a dispute may arise between contractor and the organization. So, a dispute resolution process should be specified in contract to be signed between contractor and the organization.

\textbf{Initiate Public Relations Campaign}: Privatization in public agencies is almost certain to confront opposition from various groups like employee unions, competing bidders or special interest groups who fear the loss of privileges. So proponents of contracting out strive to develop supportive coalitions to overcome such opposition.

This calls for strong participation on the part of agencies to initiate public relation campaigns to convince different groups. Such initiatives take discussion to some common agreement.

To overcome the perceived threats it is advised to take following steps in this regard:

(a) A strong campaign should be promoted through media, advertising and wherever opportunity presents itself.

(b) By creating culture of public dialogue, government should try to convince general public regarding importance of privatization and its benefits.

(c) Steps should be taken at the early stages in order to avoid any resentment.

(d) Grounds on the basis of which privatization is being sought should be promoted well among citizens. Head of the organizations, if there is need, may directly meet beneficiaries of privatization to support it.

Public relation campaigns play a vital role in arousing awareness among citizens regarding utility of privatization. In modern times, people cry for quality services in front of public agencies which are not able to deliver it. Reasons that add to such failure of delivery may be lack of funds, resources and manpower. But through privatization government tries to satisfy citizens with quality services as private agencies are sound on various grounds.

**Engage in Managed Competition:** Managed competition is a strategy in which public officials allow public sector organizations to compete with private bidders for bidding. A government agency can submit a bid document by considering same specifications as is required by a private player to follow.

Managed competition has following advantages:

(a) It allows management to work with its own labour and eliminate competition from private players.

(b) It boosts up employee morale and strengthens coordination between management and labour which further fosters better performance.

(c) Through managed competition, private bidders are kept on their toes as they strive to submit better bids with strong performance indicators\(^{25}\).

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Along with its advantages, there is dire need to understand the threats which are as follows:

(a) Sometimes public agencies do not include all their costs as they may be supported by management. In order to prevent this, agencies bid document should be properly monitored.

(b) A private agency is always required to give performance guarantee but public agency is not. Moreover, if public agency fails to perform as per standards set in contract, it cannot be held liable. So a performance bond should be included in contract both for public and private agencies and its proper evaluation should be done.

(c) Risk in contract is assumed by a private contractor with no value of bearing such risk, whereas no such risk is beared by public agencies. For example, private sector bears fines, penalties, in case of non compliance, with rules and regulations. Contrary, when public agencies fail to comply with rules and regulations then penalties are paid by tax payers.

(d) Private agencies have to pay all taxes and comply with rules. But public agencies are exempted from such regulations.

(e) Public agencies are sometimes allowed to delay their submission of bid documents until the private bids are in. Such biasness discourages zeal of private bidders to apply for bid honestly. Unless these approaches are followed, purpose of managed competition will fail to deliver.

(f) Participation of an in-house unit in bidding acts as idle if such unit is insufficient and inexperienced. It fails to do justice with contract standards.

**Fair Evaluation of Bids:** In order to foster fair bid competition, a fair bidding process should be followed. Various guidelines must be taken into account before considering evaluation:

(a) An invitation of bid should be advertised on broader scale. Various mediums can be used to advertise like newspapers, mail can be sent to firms, contacts can be extracted from telephone directories.

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(b) Enough time gap must be given from advertisement date to due bid date for preparation.

(c) In case if doubt and queries arises among bidders, they can be called for discussion to overcome the riddles.

(d) If bidders are asked to submit bid documents in response to request for qualifications, then each proposal should be evaluated in various criteria’s like cost involved, technique to be used. Finally rank should be assigned on the basis of such evaluation.

(e) Multiple bid prices create confusion in bidding process. It paves way for biasness as chances of lower bid in selection increases as compared to other bids.

(f) Bids should be selected on appropriate grounds as malpractices damages credibility of future bid prospects.

(g) Rebidding should not be sought. In case, a bidder fails to fulfil requirements i.e. may be incomplete documents, then bidding process should move on.

(h) Announcement regarding award of contract should be communicated to winner. There must be time lag between date of award and contract starting date so that contractor can mobilize for his work.

(i) There must be bid bonds and performance bonds for initiating serious bidding process. Bonds like performance helps to keep contractor attentive. A committee can be formed for evaluating such performance. Member of committee can be from chief executive’s office, management personnel and audit officers etc.

**Assess the Bids and Award the Contract:** The comparative cost analysis of all bids is necessary to find out the best bid and credibility of the vendors. The in house and contracted out services should be compared to analyze the difference between the two; the following picture depicts the grounds on which it can be compared:
Comparing In-House and Contractor Cost

<table>
<thead>
<tr>
<th>IN HOUSE COST</th>
<th>COST OF CONTRACTING</th>
</tr>
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<tbody>
<tr>
<td>Direct operating cost (salaries, wage, Benefits, material)</td>
<td>Bid price (including capital expenses, profit and operating revenues.)</td>
</tr>
<tr>
<td>Overhead charges like supervision Dept. overhead, government overhead)</td>
<td>Unavoidable overheads.</td>
</tr>
<tr>
<td>Capital expenses</td>
<td>Semi-avoidable overhead</td>
</tr>
<tr>
<td>Charges for fixed capital</td>
<td>One time transition cost (start up, vacation, Early retirement etc.</td>
</tr>
<tr>
<td>Current monitoring cost</td>
<td>Contract management and monitoring</td>
</tr>
</tbody>
</table>

**Contract Administration:** Contract administration is of great importance to keep a track of various events and ensuring smooth documentation. The plan of contract administration is significant in ensuring that a contract is properly monitored. The checklist that may include identification of deliverables, landmarks, due dates, list of all contract modifications and summary of all important dates. Contract administration also entails the method that the organization will adopt to monitor the contractor and the individuals performance. The organization must consider these following factors while carrying out the contract administration plan.

**Organized Filing:** The well organized contract plans are back bone of contracting out process as it carries all vital information pertaining to the contract. It would be of immense help for the organization to improve and analyze the contracts for future. The major important tools of contract administration include signed copy of the contract and purchase order, modifications, monitoring plans, disaster plans, method of evaluation and award of contract, minutes of meeting, contract correspondence, survey reports, performance reports, records of complaints and disputes.

**Written Policies and Procedures:** The well designed written policies and procedures play a pivotal role in contracting administration. According to American Management Association and the National Institute of Governmental Purchasing recommend that many of the following subjects be included in policy and procedure manuals:

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• Roles and responsibilities of the agency personnel must be defined clearly that who is responsible for contracting activities and who has the authority to take particular actions.

• Guidance on documenting interaction with the contractor and reports detailing contract monitoring efforts should be included in contract administration plan.

• There is need to define conflict of interest and steps that should be taken to overcome them.

• Standard contract terms and conditions of contracts.

• Guidance on assessing risk of poor performance and the methods that should be used to monitor performance.

• Assuring the return of all items including terms and conditions of contract items and it must be clear that there are no outstanding claims, and that the vendor has met all the deliverables of the contract.

• Contract administration plan must carry well written rules on that how disputes between the organization and contractor will be resolved, including the specific duties of official 29

Supervise, Assess and Insist on Contractor Performance: There is need for effective procedure to monitor performance of contractor and judge it on the basis of set standards. It calls for close monitoring of work performed by contractor as loose monitoring can lead to poor quality of services. The main objective of monitoring and evaluation is to provide good services at fair price. Without proper monitoring and effective supervision the contracting out would be curse and burden on government agency. The government unit is ultimately accountable for the cost and quality of contracted service, monitoring and evaluation must also be carried out. Sometime organizations that contracts out for a service fail to monitor the work and so essentially abdicate their role. In this backdrop, agencies are always advised to keep proper pace of monitoring and evaluation simultaneously with work of contractor so that errors can be detected early and prevention can be sought.

For systematic evaluation and monitoring, a team should be formed which can judge performance of contractors. It can be established in form of a committee or a group 29

29 Ibid
which is headed by a professional. He should be in charge of the monitoring team and should adhere and ensure the following:

(a) Ensure that contractor has all legal documents required to carry on work.
(b) To check whether work is being carried out as per contract terms or not.
(c) To verify that services being delivered as per set standards or not.
(d) To verify work performance in conformance with budget, schedule and safety rules.
(e) To check whether contractors record are complete or not.
(f) To check and verify authenticity of payments by contractor to other parties.
(g) Whether there is need to introduce changes in the scope of contract.
(h) To take feedback from citizens about services being delivered.
(i) To furnish full information about contractor’s performance to government agencies through performance reports.
(j) To suggest measures in case of deviation of performance.
(k) To impose penalties and fines on contractors for non compliance of rules and terms of contract.
(l) To maintain a proper link between contracting agency and contractor.
(m) To keep contractor and his staff on their toes by surprise inspections and visits.
(n) To keep contractor informed in case some changes are introduced by government agency.

The proper monitoring and supervision is the gravest element of contracting out process. The monitoring phase holds the key to success and can keep the vendor on toes to adhere the enshrined in the contract. In case of non observance of the provisions of the contract by the private party; personal responsibility of the concerned officials should be fixed.\textsuperscript{30} Monitoring of contract is not an easy task. A proper planning is required for fixing various parameters to evaluate performance. To serve this purpose, a proper layout of elements required to initiate monitoring action is

required. It will include manpower required to form monitoring team, training manpower and so on. Enhancing competency levels of officials is crucial issue in making the process goal oriented. The officials must have sound ability to use knowledge in various situations like monitoring techniques such as inspections, interim reviews, testing and auditing. Competency of staff and high morale in contract administration is very much necessary to make it safe and productive. Duties and roles must be specified to the officials working on contract administration.\textsuperscript{31} It should be kept in mind that contracting out should not sacrifice public interest or lessen the quality of service. The motive is to ensure public welfare in cost effective way. There should not be any kind of maladministration or it gives way to corruption.

## 2.7 CONCLUDING OBSERVATIONS

Above discussion on review of the literature of contracting out brings forth a twelve requisite steps for successful contracting out process namely securing top management participation, detailed study for privatizing a specific service, well demarcated service, cultivation of competition among potential bidders, request of expression or interest, employee transition, preparation of bid specification, role of public relation campaign, fair evaluation of bids for potential future, awarding a contract, contract administration and monitoring contract compliance. The literature also revealed that the adherence of above mentioned steps with precision can yield the fruitful results in cost effective manner without compromising the service quality.

\textsuperscript{31} David Fourie, \textit{Op.cit pp.}