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A SHIFT FROM IN-HOUSE TO CONTRACTING OUT

A Public Management View on Delivering Services

Master's Thesis in
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Several municipalities are currently contracting out their service deliveries with varying outcomes. Especially big cities, such as Helsinki and Vantaa, are looking for increased efficiency and meeting their customer's needs better through contracting out public service deliveries. There is no simple answer to the question whether contracting out public service deliveries is the best way to organize the delivery. However it undeniably seems that contracting out offers benefits, but certain conditions have to be met in order to realize positive outcomes.

Unprofessional contract management and poorly managed competitive tendering have inflicted multiple problems on Finnish municipalities. These issues indicate that there is a lack of expertise in the municipalities to manage the competitive tendering according to the law and manage the contracted out service delivery.

Hence this study aims to offer guidelines for better public management with contracts. The specific research questions are how managing contracted out service deliveries differs from managing in-house service deliveries and how public service deliveries should be managed in order to achieve success.

This is a theoretical study, which introduces two management doctrines, public service management and public contract management. Public contract management is divided into managing the process of contracting out and managing with contracts. The theory illustrates the background of contracting out, public service management, the special characteristics of public services, the phases of the contracting out process and management with contracts.

The method of study is comparative, as managing in-house delivered public services and managing contracted out public services are compared throughout this study. The material analyzed in this study is an inclusive combination of publications from achieved scholars within the field of public management.

Managing in-house delivered public services and managing contracted out public services differ from each other in multiple public management areas. Correspondingly similarities between the management doctrines were recognized, but the differences were more significant. The major differences and similarities between the management doctrines were identified within the management areas of planning, organizing, budgeting, directing, coordinating, communicating and monitoring the service deliveries.

Public service management and public contract management require differing managerial skills as the means for achieving success in management are dissimilar. The most significant difference between public service management and public contract management are the management instruments. As a public contract manager depends on the contract, a public service manager cannot achieve success without motivated employees.

KEYWORDS: Management, Public, Services, Contracting Out

1. INTRODUCTION

1.1. Background of the study

This study is inspired by the active discussion considering contracting out public service deliveries; the question is extremely controversial and attracts differing opinions from the delivering organizations and the citizens consuming public services. Several municipalities are currently contracting out their service deliveries with varying outcomes. Especially big cities, such as Helsinki and Vantaa, are looking for increased efficiency and meeting their customers' needs better through contracting out public services. (see Kerkelä 2010; Saikkonen 2010; Savolainen 2010.)

There is no simple answer to the question whether contracting out public service deliveries is the best way to organize the delivery. Multiple scholars have suggested various opinions and views on the subject (see Osborne & Gaebler 1992; Lane 2000; Cohen & Eimicke 2008). It undeniably seems that contracting out offers benefits, but certain conditions have to be met in order to realize positive outcomes, since there are multiple factors contributing to the successfulness of a contracting out process. This study discusses the process of contracting out public services, especially concentrating on public contract management issues through comparing managing contracted out services with public service management.

Unprofessional contract management and poorly managed competitive tendering have inflicted multiple problems on Finnish municipalities, for instance Lahti is currently planning a return to in-house service delivery, since it is currently in court with a private organization that lost a competitive tendering. Additionally a building process is delayed in Järvenpää as the parties are waiting for a verdict from the market court. These situations indicate that there is a lack of expertise in Finnish municipalities to manage the competitive tendering according to the law and manage the contracted out service delivery. Hence this study aims to offer guidelines for better management of contracted out public services. (Ojansivu 2011; HS 2011; see Vainio 2011).

Rusanen (2001: 9) states that most of the work performed in the municipalities is related to delivering public services. Therefore paying attention to managing these services,

whether contracted out or not, is crucial in order to improve the functioning and efficiency of Finnish municipalities. The yearly value of public procurements is billions. In 2010 there were total of 19 300 procurement announcements published in HILMA, which is a channel of procurement announcements provided by the Ministry of Employment and the Economy. The evaluated total value of these procurements was over 20 billion euro. (Ministry of Employment and the Economy 2011b).

The high amount of yearly public procurements, although not all of them service deliveries, indicates that contracting out has become a permanent part of Finnish public administration. Therefore investing in procurement expertise in municipalities is increasingly important as the number of cases in the market court is constantly rising. The market court is a special court hearing market law, competition and public procurement cases (Market Court 2011). The increase in market court cases indicates two issues: the number of public procurements is rising and there are difficulties in following the law in the process of contracting out. (Karisto & Lohivesi 2007: 20.)

There are various factors contributing to the need for reshaping the public sector and renewing its ways of functioning in Finland. First, the traditional Nordic welfare state has faced criticism since the recession 1990's. This criticism has led to requirements for change within the public sector and its organizations. The recent trend has been to introduce individual choice and competition as tools for improving and developing the public sector further. Competition and market-like ways of acting have become increasingly popular after the recession 1990 and especially during the last decade in local politics and economical decisions. This development is creating a new culture of doing instead of public organizations having a monopoly position within the market. (Fredriksson & Martikainen 2008: 11, 63.)

Second, the high costs of sustaining the traditional welfare state and the aging population structure are driving change in the public sector. (Kanninen 2002: 9–10.) Third, the pressures to deliver more services for less is increasing while the population of Finland is aging and, in proportion the demand for, for instance health care services, is rapidly growing. However the allocation for public service deliveries is not

increasing; this creates a situation where the services can no longer be delivered solely in-house, since there simply are not enough funds. This development has strengthened the private sector's role as service deliverer. (Kähkönen & Volk 2008: 9.) And finally, the idea of contracting out services has gained popularity since the public organizations are often seen as inefficient and the private sector is in comparison viewed as dynamic and efficient. (Huque 2005: 69.)

Lith (2000: 8) states that the public sector cannot maintain the same level of welfare services in the future without the assistance of private organizations. Private sector is needed in order to meet the demand for the service deliveries and to increase the efficiency. Furthermore the public opinion is that contracting out service deliveries is not a trend that will pass in time; one reasoning for this phenomenon is that a significant amount of public employees are retiring in the near future. There will not be enough staff to deliver all services in-house. (Valkama & Kallio 2008b: 90.)

Further concerns about organizing public service deliveries and the limitedness of the public resources have been brought to attention several times in the 21st century. Fredriksson and Martikainen (2008: 34) conducted a research about how the citizens consuming public services would wish to secure the quality of the services. When having to choose between raising taxes, going further into public debt or contracting out public services, the result of the research was clear. Contracting out was seen as the best option.

After Finland affiliated to the European Union and the multinational cooperation started increasing, the regulations considering the public service deliveries became more liberal. In the beginning of 1990 the Finnish government reduced the regulations considering public service deliveries. Following this development came along the new municipal law (Kuntalaki) in 1995, also known as the law of possibilities, since it allows more freedom in organizational issues. (Valkama 2008c: 162–163.) In 1993 the municipalities' functions were specified as organizing (instead of self-producing) the service deliveries in social and health care services. This meant that the municipalities

could choose whether to deliver services in-house or contract out the service delivery. (Kanninen 2002: 25.)

Contracting out services in order to improve quality and increase efficiency was implemented traditionally in private sector organizations, but the doctrine of New Public Management (NPM) has introduced the idea of contracting out service deliveries to public organizations as well. NPM suggests that contracting out service deliveries will increase the allocative efficiency of public organizations. (Lane 2000: 193). Hence the main ideas of NPM are shortly described in the following chapter.

New public management

The criticism for the public sector, which started arising in the 1980's, is crystallized in NPM. NPM criticizes the public sector for the lack of efficiency, quality and customer perspective. According to NPM the private sector operation models should be implemented in public organizations. The public sector is often seen as outdated and bureaucratic and public services, for instance social and health care, as merchandise. (Martikainen 2009: 12–13.)

NPM suggests that the personnel and public service deliveries are to be managed through series of contracts and the public managers should become professional contract managers. Contracting out will help clarifying the tasks and objectives of the public service deliveries. As service deliveries are contracted out, the role of public managers becomes more central in the organizations since professional management is an essential requirement for success in contracting out. (Lane 2000: 147.)

The main reasoning for contracting out public service deliveries is that it increases efficiency. Whether or not public services should be contracted out should no longer be an issue, instead the required conditions for success in contracting out should be discussed and carefully determined. (Ibid. 147.) The basic purpose of NPM is to employ competition in order to reduce production costs (Ibid. 151). The main objective of contracting out services is to increase the economic efficiency of public service

deliveries. According to the doctrine of NPM the efficiency of the service delivery is improved since a contracted out service delivery is 1) voluntary, 2) goal-oriented, 3) incentive based, 4) specified, and, 5) time frame is limited. (Lane 2000: 52.)

1.2. Specification of the research question

The issues and examples presented above confirm the fact that there is a need for research considering public service management with contracts. Hence this study discusses particularly the management of contracted out services in comparison with managing in-house delivered services.

Municipalities in Finland are required by law to deliver services to their citizens. However the municipalities have the freedom to choose how to organize the service delivery. As it is stated in the law, the municipality's role is no longer to deliver the service in-house; it is to organize the service delivery. (KuntaL 2 §.) This means that the municipalities are now functioning in a market situation where their role is simply to finance the service delivery and ensure the quality and adequate quantity of the services. (Kähkönen 2001: 14.) This freedom of choice and the various other factors discussed in the previous chapter have contributed to contracting out public service deliveries extensively. The recent changes in the law and political reforms support contracting out, since contracting out is believed to decrease the costs of delivering public services and increasing the efficiency of the process.

However, the question is not always whether or not to contract out a service delivery, at times there simply are no resources for organizing an in-house service delivery. As the manager of health care services in Lahti, Risto Raivio, says "we would rather deliver health care services ourselves, but we do not have enough human resources." (Ojansivu 2011.) This situation, that more and more municipalities in Finland are facing, strongly indicates that the discussion considering whether or not to contract out public services is out dated and the attention should be diverted to developing means to managing with contracts more successfully.

The aim of this study is to answer the questions how managing contracted out service deliveries differs from managing in-house service deliveries and how public service deliveries should be managed in order to achieve success.

The management of public service deliveries is discussed in two different perspectives; managing in-house delivered services and managing contracted out services. The management of in-house service deliveries is included in this study, since the requirements of managing the process of contracting out and managing with contracts are easier to comprehend in the context of public service management.

Two separate phases can be recognized in public contract management: managing the process of contracting out and managing with contracts. The question, how managing contracted out services differs from managing in-house delivered services, is approached through comparing public service management and public contract management. The major differences and similarities between public service management and public contract management are discussed throughout the study and finally concluded in table 3.

Contracting out public services is also discussed as a phenomenon, since the concept of public contract management cannot be understood without being familiar with the process of contracting out. For this reason this study aims to clarify why contracting out services has become increasingly popular in Finland. Additionally this study discusses the main issues related to contracting out public services, such as making the make-or-buy decision and most importantly contract management. The research question is approached by first discussing the doctrine of public service management, then presenting the phases of the contracting out process and then discussing management with contracts. In the concluding chapter public service management and public contract management are presented in comparison with each other as the central findings of the study are further discussed.

Figure 1 presents the main phases of the contracting out process. Previous study has mainly focused on discussing the competitive tendering phase of the contracting out

process and laws considering the competition. (see Kähkönen 2001; Rusanen 2001; Valkama 2008). However as this study discusses each phase of the process, the two latter phases are especially stressed as figure 1 indicates. Managing the process of contracting out is discussed from the make-or-buy decision to the writing and negotiating of the contract, since professional management in this phase creates a foundation for successful management with contracts.

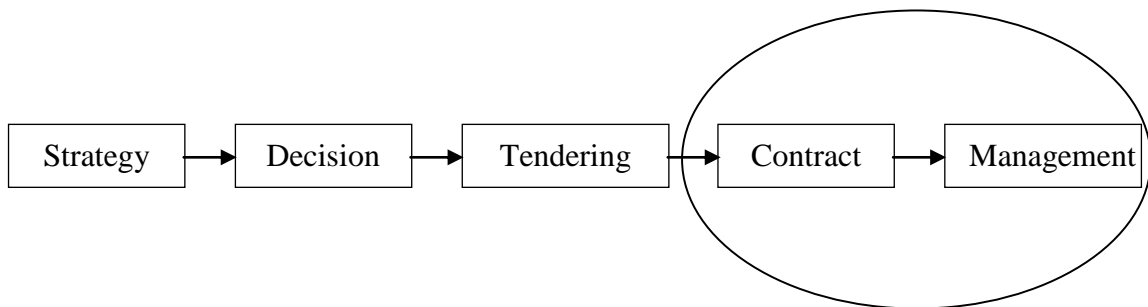


Figure 1. The phases of the contracting out process (modified Karisto & Lohivesi 2007: 21.)

The perspective of this study is administrative as it focuses on the organizational conditions and public management requirements. The assumption that managing in-house services and managing contracted out services differ from each other is the basis of the comparative approach in this study.

In this chapter the background of this study, as well as the research question, structure and main concepts are presented. The second chapter discusses the characteristics of public service deliveries and public service management. Service management is presented as a basis for managing contracted out services. Chapter three discusses the process of contracting out, beginning from forming the organizational strategy and ending with signing the contract with the chosen contractor. After the phases of the process have been presented, public management with contracts is discussed in chapter four. Finally, in the concluding chapter five, public service management and public contract management are compared and the central findings of the study are presented.

As public service deliveries are contracted out the contractor may be another public organization, public utility, third sector or private sector. This study discusses contracting out services to private organizations and the specific issues of public and private sector partnerships. This study is written from the purchasing public organizations perspective, focusing especially on public management issues.

1.3. Main concepts

As explained earlier, this study discusses the management of in-house services and contracted out services. The central terms related to the field of research are specified here in order to clarify how these terms are understood in the context of this study.

Public service delivery

A public service contains four basic features, it is: 1) immaterial, 2) a process, 3) produced and consumed or consumed as it is produced and 4) the customer participates in the service process (Grönroos 1987: 29). More specifically the concept of public service is delimited to individual services, individual service meaning that an individual person is the customer of the service. (Ibid. 20.)

In Finland the most significant publicly delivered services are social and health care. The municipalities have a responsibility to deliver health and social care to the citizens. These include for instance doctoral services, daycare for children and care for the elderly. (Kanninen 2002: 37, 41.) This study discusses public services that are delivered or purchased by the Finnish municipalities from the private sector.

The term public service *delivery* refers to the whole service process from forming the service strategy to the consumption of the service.

Customer

The citizen, needing and using public services, is called “asiakas”. The Finnish term “asiakas” refers to two English terms; client and customer (Valkama 2009: 26). The

terms client and customer have differing meaning, a client is not seen as independent since the deliverer of the service determines the content and goals of the service. In comparison a customer has a more active role and he/she is determining the service. (Häikiö 2007: 151.)

The basic meaning of the term customer is a person who receives and benefits from a service and is paying for the service delivery. In the 21th century the use of the term “asiakas” has increased significantly in Finnish, ”asiakas” as a citizen who makes choices and is acting independently as an individual in relation to public services deliveries. (Valkama 2009: 28.)

Contracting out

Contracting out signifies that a service is delivered outside of the public organization that is responsible for organizing and funding the service delivery. When a service delivery is contracted out, a private organization is delivering the service for the citizens as is agreed in a contract written with the purchasing public organization. The public organization pays a private organization for delivering a service, whilst maintaining full responsibility for the service delivery. (Blum 2009: 64.)

Soloway & Chvotkin (2009: 193) define contracting out as follows: in effect, a temporary business relationship based on competitive processes and designed to develop and implement a needed mission solution, fill an immediate gap in skills or other aspects of the organization, or improve performance and efficiency.

Management

Management is “getting things done through people” or “planning, organizing, controlling, and evaluating” (Pollitt & Harrison 1992: 14). Service management is a management approach in which management procedures are geared to the characteristics of services and the nature of service competition (Grönroos 2000: 195). Public service management is further determined in table 1 in the following chapter.

By managing with contracts is meant efforts undertaken after signing a contract to obtain successful contractor performance (Kelman 2009: 171). The management of competitive tendering is separated from contract management; in this study managing this phase is referred as managing the process of contracting out.

Efficiency

Efficiency is pursued through contracting out service deliveries and increasing efficiency is often named as a main objective for contracting out public services. Therefore the term is explained in this context. Efficiency signifies that functions are performed in the best possible way (Kanninen 2002: 19). The term efficiency often has a negative tone, even though it actually is a positive term. Wide perspective of efficient service delivery includes for instance customer-satisfaction and enjoyable working environment. A service delivery process is efficient when it maximizes the wellbeing of citizens. (Ibid. 18–19.)

There are external efficiency and internal efficiency. Internal efficiency meaning the way the organization operates and its productivity, in comparison external efficiency is the service output the customers receive. (Grönroos 2000: 182.)

2. MANAGING PUBLIC SERVICES

Grönroos (2000: 163) states that the customers of public services deserve more than just a good service package, a public service delivery has to be a functioning and efficient service process as well. Ensuring the functionality of the delivery is the public service manager's main responsibility; the manager is responsible for the success of the service delivery. Managing public service deliveries is demanding as funds are limited, politics is involved in the process and the media is closely monitoring the delivery of public services.

Service management in public organizations differs significantly from private sector service management, since public organizations cannot determine their objectives themselves nor can they choose their customers or the implemented policies. Furthermore, the fact that public services are publicly founded increases accountability; in addition to in-house performance measurement, a public organization is held responsible to the public. All these factors contribute to the complexity and uniqueness of the public service management. (Hartley & Skelcher 2008: 7–8.)

Pollitt & Harrison (1992: 2) further argue that managing public services differs from private sector management for several reasons, the main basis being the special characteristics of the public services. The goal of a public service delivery remains often undetermined, since a lack of consensus is often an issue in public sector organizations. Also lack of competition in the service market is typical in the public sector. Increasing the volume of an in-house service delivery often provides insignificant profits or no profits at all; this does not usually apply in the private sector. Finally the public law considering public organizations limits the freedom of functioning in public organizations.

Hartley & Skelcher (2008: 12) state that managing public services consists of accumulating allocation and using the organizational resources for delivering services and delivering measurable outcomes; outcomes for the customers of the delivered

services as well as outcomes of public management and other organizational functions. On the other hand Grönroos (1990: 120) continues that managing the external efficiency and maintaining a customer-oriented focus are crucial for successful public service management. Internal issues are additionally important, but they cannot become the manager's top priority.

Table 1. Definition of public service management (modified Grönroos 1988, quoted in Grönroos 1990: 117.)

PUBLIC SERVICE MANAGEMENT IS:
- To communicate with the customer and understand the customer's needs and requirements for the service delivery and how the different phases of the service delivery contribute to serving the customer's needs. That is to understand how total quality is perceived in customer relationships and how it changes over time;
- To understand how the public organization (personnel, technology and physical resources, systems, and customers) will be able to deliver quality services efficiently and economically;
- To understand how the organization should be developed and managed so that the organizational and political goals are achieved; and
-To make the organization function so that the goals are achieved and the objectives of all parties involved (for instance political leaders and the citizens needing and using public services) are met.

In table 1 above a broad definition of public service management is provided. According to Grönroos the core of public service management is to understand the customers of the public service deliveries, increase customer-orientation, realize how every function in the delivering organization contributes to the success of the service delivery, to be objective enough in order to recognize possible problems in the delivery and improve the functioning in the problem areas. It is essential that the public service manager is able to comprehend the service delivery as wholeness.

Grönroos (1990: 118) further specifies that only two major shifts in focus distinguish public service management and traditional public management. These are: 1) a shift from an interest in internal consequences of performance to an interest in the external consequences, and 2) a shift from a focus on structure to a focus on process.

2.1. Characteristics of public services

Traditionally public services have been delivered by the public sector but nowadays the public sector is only responsible for organizing the service delivery. (see Kuntal 2 §; Kähkönen 2001: 14.) However the source of allocation for delivering public services has remained the same, the allocation for public service deliveries mainly becomes from tax revenues. The decision how public services are delivered is a matter of legislative mandate (Picherack 1987: 244).

Delivering public services is the most important function in a public organization for number of reasons, most of all because of their scale. The public expenditure consists mainly of allocation for public services deliveries. Efficient delivery of public services is crucial to the economic stability of a country. Public service deliveries are additionally significant sources of employment, especially on the local level. (Hartley & Skelcher 2008: 5–6.) The best way to increase overall public sector efficiency is to concentrate on improving the management of service deliveries, since delivering public services is the main function in municipalities and the most significant item of expenditure. (Grönroos 1987: 10.) The significance of public services, most of all economic, highlights the central role of a public service manager. Professional service management is the key for delivering public services efficiently to citizens. A significant part of publicly delivered services fall under two categories: social and health care services. (see Kanninen 2002: 37, 41.)

According to Hartley & Skelcher (2008: 9) the sole nature of public services is far different from private services. As the private sector seeks financial gains, public services are mostly expected to produce public value, for instance health care services.

Additionally the clientele of public service deliveries is significantly different from private sector's. A public organization must deliver services to each and every citizen regardless of their ability to pay or demand service. The public sector is also obligated to maintain service deliveries that do not provide financial profits. On the other hand Grönroos (1987: 22) argues that all services are basically similar, it is solely the form of the service delivery that varies. But when public services are contracted out this comparison is not as clear as Hartley and Skelcher state, since the main objective of contracting out public services often is financial gains, but at the same time public values must be realized in the service delivery. The differences between public and private services are diminishing rapidly. Efficiency, customer satisfaction and accountability are important characteristics for a public service delivery; regardless which sector is delivering it (Cohen & Eimicke 2008: 42).

Realizing public values will however remain as a part of public service deliveries. Setting the objectives and especially prioritizing service deliveries is challenging in a public organization, since the requirement for equality cannot be disregarded, for instance in health care, the services must be provided to each citizen. It is easier for public service managers to state that every function is important, rather than identifying the core competences and efficiently delivering the most essential services. (Pollitt & Harrison 1992: 4.)

A challenge in delivering public services is that the demand for public services can vary considerably over time; however the allocation available for the service delivery does not vary in proportion. In case of excess demand the public service manager is required to determine who actually needs the service and who does not. This procedure is called rationing a service. (Ibid. 7.) This issue is often used as an argument defending contracting out public services, since a private organization can be more flexible, for instance in employing more staff when needed.

The nature of public services makes specific standardizing of the delivery challenging, since the number of customers is high and the citizens' demands vary significantly. The incapability of specific standardization contributes to difficulties in performance measurement; if the service deliveries are not clearly separated from each other, the

outcomes of each service are impossible to measure individually as there are often multiple factors impacting on the final outcome for the customer. (Pollitt & Harrison 1992: 8.) These problematic areas can be at least to certain extent be improved by contracting out service deliveries; further arguments are stated in chapter 3.1.

Before further discussion the actual delivery process of public services the ambiguousness of citizens as the users of the services must be presented. The complexity of organizing the delivery of public services cannot be understood as a whole unless the complexity of the clientele is comprehended.

The customers of public services

Each citizen is entitled to benefitting from public service deliveries, for instance public health care, and, on the contrary each citizen can become social care's customer whether they aspire for it or not. The diversity of public service deliveries is reflected on the diversity of public sector's clientele. Häikiö (2007: 151) determines that public sector's customers are individual citizens who are able to influence to the content and form of public service deliveries by voicing their opinions about the functionality and quality of the delivered service.

Traditionally the division between citizen and customer has been clear; the welfare state delivers services to a citizen and a customer purchases what she/he needs from the private sector. (Häikiö 2007: 149.) Being a citizen has meant having obligations rather than having rights, but nowadays the situation has turned. This development has contributed to the fact that public organizations are expected to deliver customer-oriented services. (Valkama 2009: 28.) The fact that the citizens are defined as customers has given the public the idea that they can choose from service options, place demands and complain if the customer service is poor or the quality of the service delivery is not satisfying. (Ibid. 29.)

The citizens are considered as the clientele of public organizations, this clientele can be divided into different four groups. The first group is clients and customers, the second is patients, the third is users and the last one is consumers. All these terms have different meanings and they are used in differing contexts, additionally all the groups have

varying needs and requirements for a public service delivery. This diversity is the core of complexity in public service management. (Valkama 2009: 27.)

The various relationships that are formed between the citizen and the service deliverer are presented in table 2 below. As is described in the table a patient has little freedom to choose the form of the public service or demand for specific type of care, the delivering organization is able to form the content of the delivery. A user does not place demands, but accordingly the delivering organization does not have must freedom, the service delivery is standardized. A customer is active in the process of planning the service content and the customer usually voices his/hers demands for the service clearly. A consumer is a term that is most commonly is used in relation with private organizations; a consumer places demands regardless of the deliverer.

Table 2. The citizens as the clientele of public service deliveries (modified Hasenfeld, Rafferty & Zald 1987: 402.)

The deliverer's freedom to modify the service's content and form	Citizen's freedom to choose and demand		
		Minor	Significant
	Significant	Patient	Consumer
Minor	User	Customer	

The citizens as the customers of public service deliveries are a very ambiguous group. They are expecting customer-orientation and value for their money. Additionally all the four customer types are to be considered as a public service delivery is organized and the service strategy is formed. The citizens as customers definitely add challenge to the delivery of public services; these challenges are further discussed in the next chapter.

2.2. Delivering public services

In order to deliver public services functionally, an organization must have a clear understanding of how the services should be delivered and what factors are affecting to the delivery process. (Grönroos 1987: 12.) In addition constant demands for doing more for less are impacting public service management. These demands have institutionalized as ambition for economy, efficiency and effectiveness in public service deliveries. (Collier 2008: 47.) According to Valkama (2009: 34) the deliverer of public services should avoid standardizing the content and the form of the service strictly, since consulting the customer will increase the experienced quality of the delivery.

Sutela (2003: 59) argues that in practice there are three different means of delivering public services to citizens; in-house service delivery, cooperation with other public organizations, for instance with other municipalities, and contracting out. Contracting out signifies that a separate public or private organization is delivering the service. These means are illustrated in figure 2.

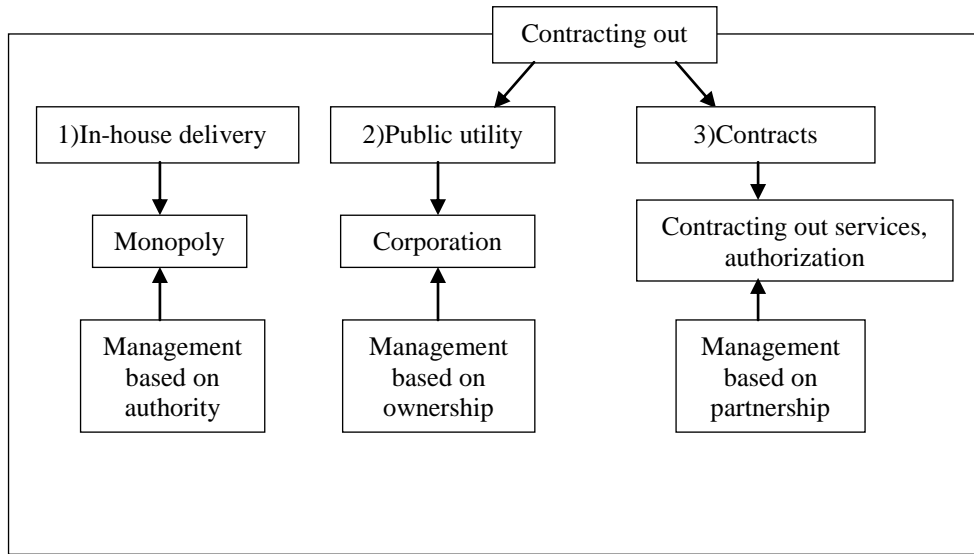


Figure 2. Three basic options for organizing a public service delivery (modified Sutela 2003: 62.)

The first option, in-house delivery is a traditional form of organizing the service delivery. Delivering services in-house creates a public monopoly and requires a hierarchical organization structure and hierarchical management. The second and third option both require contracting out the public service delivery. In the second option the deliverer is public, often a part of the purchasing organization that is divided into a deliverer and a purchaser. A competitive tender must be organized and if the public organization is rewarded with the contract, this option can be adapted. This model is called the provider – producer model. When the deliverer is part of the purchasing organization, the purchaser is managing the service delivery. The third option is that a private organization places the tender and is rewarded with the contract. In this scenario the management of the service delivery is based on managing the partnership with the contractor. (Sutela 2003: 62.)

Regardless of the service delivery form; there are four requirements, defined by Grönroos (1987: 87), which are to be met in order to deliver economical and quality services to the citizens:

1. Strategic requirements
2. Organizational requirements
3. Management requirements
4. Informational and attitude requirements

All requirements mentioned above are crucial in order to successfully deliver public services to the public. Especially management requirements are essential, since public service managers are responsible for motivating the customer servants and promoting the willingness to serve in an organization. (Ibid. 87.) An interest in delivering public services and an appreciation of delivering quality services among all employees, including management, is an essential requirement for successful service delivery. (Grönroos 1990: 244.)

Determining the form of a public service delivery should be based on evaluating the objectives of the services delivery, availability, and, quality and efficiency (Rusanen 2001: 10). Sutela (2003: 222) further argues that the form of the service delivery should not be relevant to the customer; the content and quality of the service is what matters. The public sector must assure the realization of the citizen's fundamental rights regardless how the service is delivered.

The public is both funding and consuming the service delivery. This is the essence of the controversy in delivering public services; the public demands high quality services but is not willing to pay more taxes. (Collier 2008: 56.) The citizens expect quality services, it does not matter which sector is delivering the public service, as long as the quality of the consumed service is adequate. According to Valkama (2009: 29) customer-orientation is often mentioned as a requirement for delivering high quality public services, yet how the customer-orientation should be implemented in practice is seldom said. The main issue with implementing customer-orientation into public service deliveries is that some of the public services are delivered to the customer regardless what his/hers needs or requirements are, for instance police services or social care.

2.3. Service strategy

Each public service organization forms a service strategy that determines how services are going to be delivered and what are the objectives for these service deliveries. Additionally an important phase of the strategy forming process is to decide which services are delivered in-house and which are contracted out. The service strategy is the bases for make-or-buy decisions.

As the strategy is formed, the public service manager should not solely concentrate on solving financial problems or coping with increased competition, the focus should be upon customer-orientation. The decision making process should be guided by the predicted effects on external efficiency and customer satisfaction, naturally the cost considerations and the effects on internal efficiency cannot be completely discarded. As the service strategy for delivering services is formed top priorities should be service quality and efficiency. (Ibid. 111.) On the other hand according to Picherack (1987: 243) the formation of the service strategy in public organizations occurs according to resource availability and is deliverer-oriented, since public organizations have limited funds and customers' needs seldom have affect on the amount of allocation. The resources are the basis for the service strategy since public organizations' budget and human resources limit the extent of service deliveries.

The formation of the service strategy is based on combining the customers' needs and expectations with the allocation and political outlines. A complex public organization, delivering various services, can become more active as a result of careful service strategy formation process, and improve the services by combining the customers' needs and expectations better. On the other hand, ensuring that the service strategy is appropriate and understood, and simply knowing the organization, are management tasks that become increasingly difficult in larger public organizations, for instance in big cities. (Picherack 1987: 247.)

The public service manager is responsible for the content and functionality of the service strategy, which is an important management tool. In order to motivate every single employee, from management level to customer servants, the service manager

should ensure that everyone is familiar with the service strategy and acknowledges what their role in the service delivery process is and what is expected from them as an individual. (Grönroos 1987: 91.) Picherack (1987: 252) further argues that another mean for increasing employee motivation is decentralizing the budgeting process and increasing employee involvement in the strategy formation process. Involving the employees will encourage customer-orientation and efficiency. If employees are not included in the service strategy formation they will feel disconnected from their work. According to Grönroos (1990: 222) the service strategy should also be internally marketed to the employees. Internal marketing is a management strategy, meaning that the public service manager must convince his/hers employees that they are delivering quality services. The goal of internal marketing is to better motivate the employees.

A carefully formed service strategy is the basis for achieving a service culture in a public organization. A service culture means that the public employees can be characterized as being service-oriented. A functional service culture improves the internal working environment within the organization and improves the external quality of the delivered public services. Hence a public service manager should concentrate on promoting a service culture and after a functioning culture is achieved, maintaining it. (Grönroos 2000: 360.) In order to deliver high quality services to citizens the organizational culture must transform from stiff bureaucracy into a service oriented culture. (Grönroos 1987: 15.)

Grönroos (1990: 114) further argues that every service deliverer needs guidelines for performance. Hence every public organization should form and implement service strategies, which include objectives for the service delivery and careful budgeting. If a public organization does not have a service strategy, the functioning within the organization and the quality of the service will likely be inconsistent. It is essential to set objectives for service deliveries and constantly be aware of the delivery costs. Goal setting in a public organization may seem challenging, but after carefully considering and forming the organizational strategy, the objectives are easy to determine. (Grönroos 1987: 90.)

However the objectives and main contents of the service strategy in the public sector are often defined by law; a public organization cannot determine its mission individually in order to aspire success or financial gains. Public organizations must also deliver uneconomic services and maintain public values. (Pollitt & Harrison 1992: 11.) Grönroos (1990: 243) further argues that standardizing a service delivery is extremely challenging, because of the varying conditions with different customer groups and their needs; hence the employees interacting with the customers have a significant impact on the service quality. Therefore it is important that a public organization establishes a strong service culture, which encourages customer-orientation and efficiency.

2.4. Managing the service delivery

The most important aspect of public service management is to combine a customer-oriented approach to delivering public services with efficient use of public funds. It is crucial to remember that a public service delivery is a process in which the customers play a significant role, and, the service is consumed at the same time as it is delivered. (Grönroos 2000: 163.) A customer-oriented approach to public service management is essential, since the customers compare public service performance with private sector's performance. Improving the service delivery quality through customer-orientation will provide the public sector with an opportunity to gain confidence from the tax-paying public. (Agus, Barker & Kandampully 2007: 177.) Valkama (2009: 28) further argues that customer-orientation has become a defining factor in a public service delivery, especially in health and social care.

In order to maintain a customer-oriented approach in a public service delivery, the public service manager needs to assume a service-oriented management approach. Public service management must be humane and the manager must adopt the roles of a coach and a leader. The importance of leadership and coaching, even mentorship, in service management highlights the need of cooperating and communicating with employees. (Grönroos 1990: 249–250.)

As the service strategy is concentrating on the form and objective of the services deliveries, the service manager's role transforms from leader to advisor. The manager remains responsible for monitoring the delivery, but the monitoring should be performed discreetly and the necessary improvements and guidance should be encouraging and developing. This way the public service manager obtains new authority. If the manager's authority is solely based on his/hers position in the organization, the management easily becomes discouraging. (Grönroos 1987: 89–90.) Public service managers should apply their leadership abilities in order to restructure public organizations to environments where the customer is at the top of the hierarchy. Furthermore the centre of management strategies should around the employees who are in direct contact with customers. (Picherack 1987: 251.)

Collier (2008: 52) further states that the fact that public organizations have limited funds and they struggle to satisfy the public's demands for the public service deliveries also has to be acknowledged in the context of public service management. The process of allocating service deliveries and rationing the various demands (policy making, public, governmental supervision) makes public service management challenging.

The public sector is known for its rules and regulations; hence public management has traditionally been bureaucratic and mainly based on monitoring the implementation of regulations. However, overregulation does prevent delivering high quality services. Regulations may guarantee good technical quality, but in order to achieve high functional quality the public service delivery must be flexible and the employees must be authorized to make independent decisions. (Grönroos 1987: 90.) The public service manager should keep in mind that improving the service quality does not automatically increase the delivery costs. Only one thing is often needed: a better understanding of the customers' needs and definition of how the quality is experienced by the citizens consuming the service. After these issues are determined, existing resources can be used more efficiently. (Grönroos 1990: 111–112.).

Maintaining a strong service culture is crucial, since the attitudes and performance of the employees have a direct impact on the service quality. (Grönroos 2000: 359.) Lately

the service quality has become increasingly important, since the citizens' expectations are constantly growing, the administrative focus is increasingly focused on revenue, and, the competition in the market is increasing as private organizations are beginning to offer same services as the public sector. Concentrating on improving public service quality is the best mean for gaining success as a public service manager. (Agus et al. 2007: 177.) Since the service quality consists of various different factors, it is crucial that the organizational culture and values enhance maintaining high quality. This way the service managers are able to indirectly supervise the quality. (Grönroos 1990: 243.)

The actual service delivery process is a series of transactions that all contribute to the quality of the public service. Through the application of appropriate service management practices, the process is capable of ensuring that the customer's expectations are identified and are fulfilled in each encounter. (Picherack 1987: 248.) The overall focus in public service management has to be on the service delivery process. Service management is related to process management in which the organizational structures and hierarchy are less important. If the organizational structures prevent flexibility, customer-orientation suffers. (Grönroos 2000: 197.) The need to manage all encounters between the customer and the service deliverer adds challenge to public service management, since the customer segment is so complex and the demands and needs vary significantly. (Picherack 1987: 244.)

Human resource management

The personnel delivering services to the consumer play a crucial role in the service delivery process. Their knowhow, expertise and attitudes contribute to the quality of the service. Therefore public service managers should concentrate on leading human resources and obtaining the service attitude as an example to the employees. (Grönroos 1987: 13.) There are disagreements in the field of public service management considering certain aspects, for instance quality management and measurement, but there is an agreement regarding the essential role of the service employees. The customer servants in a service organization can be referred as the face of the whole organization. (Agus et al. 2007: 177.)

Empowering the employees is crucial as it means that the personnel are encouraged to meet each customer's needs individually, hence increasing customer satisfaction. (Grönroos 1990: 121). The simple fact, that the personnel interacting with the consumers are the most important asset for the service manager, cannot be stressed enough. Service orientation improves service quality, which, in turn, positively affects profitability (Grönroos 1990: 245.) Furthermore the employees who interact with the service consumers have an important role in terms of responsiveness, courtesy and credibility in increasing the service quality and customer satisfaction. Selective recruitment of motivated employees and maintaining a customer-oriented service strategy has significant positive implications for the public service organization. (Agus et al. 2007: 177.)

The public service managers must support and motivate their employees. The organizational regulations should not be too limiting, as the customer servant must be able to make decisions quickly and independently, otherwise the service delivery becomes inefficient and inflexible. Management by objectives is suitable for managing service deliveries as the outcome of the service is more important than following strict rules and regulations. (Grönroos 1987: 14–15.) Grönroos (1990: 262) condenses the aspect of managing human resource in public service management as follows: In order to be able to produce quality services, employees need knowledge, feedback, and, support and encouragement from their managers and supervisors. Public service managers have to show genuine leadership when managing their subordinates.

Functioning communication between the service managers and the employees is also essential. On the one hand, employees need guidance and support from management in performing their tasks. On the other hand the employees have valuable information for the management for instance about the emerged issues and the needs and wishes coming from the customers. Moreover, employees need feedback in order to improve and stay motivated. (Ibid. 252.) A public service manager should inform his/hers employees on regular bases. The employees must be aware of what the wanted outcomes for the service deliveries are, additionally they should be informed whether the aims were met

and receive feedback from the manager. Successful human resource management is the key to delivering quality services. (Grönroos 1987: 90.)

2.5. Measuring in-house performance

Performance measurement is a usable tool for all public managers. As it comes to public service management, through measuring their service performance the managers are able to make necessary improvements and identify best practices. (Pidd 2008: 65.) Monitoring performance is indeed a fundamental part of service management. However the service manager should use the information gained through measurement for guiding the employees instead of controlling their actions. (Grönroos 1990: 251.) Collier (2008: 52) further states that since public managers are accountable for the performance of the organization they manage, measuring performance is essential in order to develop the service delivery in terms of better performance.

The performance of private organizations is relatively easy to measure since successful performance can be recognized by simply counting the cash profits. (Collier 2008: 52.) On the other hand Collier's view is quite narrow, since it dismisses the issue of service quality. As Agus et al. (2007: 177) argue there are difficulties in measuring service quality and these difficulties contribute to difficulties in developing the public service delivery. Bourn (1992: 27) emphasizes the fact that the objectives of the service delivery must be defined carefully, otherwise the measurement cannot succeed. This is the most important aspect in terms of measurement, if the organization has not specified what it aims to achieve, how can the success in achieving the objectives be measured?

Every organization should have a reporting system; this system should provide frequent information about the service delivery to service managers. Based on the received information the manager should measure the service delivery in terms of economy, efficiency and effectiveness. Economy meaning pursuing adequate quality with minimum costs, efficiency describes the relation between the investments and outcomes and finally effectiveness in achieving the set objectives. (Ibid. 27.) On the other hand Grönroos (1990: 122) states that in public service management it is more important to

measure the manager's success in encouraging and supporting the employees than the actual service delivery. The most crucial issues in measuring in-house performance are the process of analyzing the inputs and outputs and the relationship between costs and benefits.

Economy is often the only aspect of the service delivery that is measured, since minimizing costs is desirable. Quality and customer satisfaction are easily ignored in the measurement process. (Bourn 1992: 37.) But as Grönroos (1990: 122) argues, measuring solely how standards are met and how much cost savings were realized is not adequate, the overall efficiency and quality of the service delivery must be measured as well in order to maintain the wanted performance level. The quality of the service can be difficult to measure since every customer experiences the service delivered differently, reflecting on their individual expectations and prior experiences. (Grönroos 1987: 30.)

It is crucial that the delivering organization has a clear understanding of what service quality is and how it is formed. The overall quality of the service consists of technical quality, functional quality and the image of the public organization. Success in all three areas must be measured before evaluations about the service quality can be presented. (Grönroos 1987: 32.) The management of service quality is at the heart of public service management (Grönroos 2000: 202).

2.6. Problems in managing in-house service deliveries

There are four main areas in the delivery process where problems may arise. First, the issue of time, the delivery can become time-consuming to the consumer if the process is not flexible enough. The second pitfall is unclear job description (undefined service strategy), if the employee's job descriptions are unclear and they are not aware who is supposed to deliver certain tasks, the delivery cannot be successful. Thirdly, negative attitudes of consumer servants reflect to the customers and create experiences of inequality in public service delivery. Fourthly, the service delivery may incur financial issues to the customer, if the customer is required to travel in order to have access to the service. (Kiviniemi 1986, quoted in Grönroos 1987: 17.)

In addition Grönroos (1990: 273–275) presents four barriers to successful public service management. These barriers are:

1. Organizational barrier; a stiff organizational structure and bureaucracy prevent successful implementation of the service strategy.
2. Systems and regulations-related barrier; strict organizational rules and regulations prevent the customer servant from delivering quality services.
3. Management-related barrier; how managers treat their employees is the way the employees treat the customers. If the public service manager is not able to motivate his/hers personnel, problems will occur.
4. Strategy-related barrier; if the service strategy is unclear and there are no objectives, the personnel responsible for delivering the service do not know how to function in specific situation, hence the service quality suffers.

Unevenness or inconsistency of service deliveries is perhaps the severest problem facing service operations today (Grönroos 1990: 276). In terms of equality public services should be available to each citizen, regardless which part of the country they live or their financial situation.

The most significant risk in public service management is that the manager is not able to sell the important concept of customer-orientation to his/hers employees. If the personnel are not motivated to deliver high quality service, the overall quality and effectiveness of the service delivery decreases notably. The public service manager must measure and reward customer-orientation and high quality. (Ibid. 251.) Additionally poorly defined service strategy and unclear objectives create difficulties, as it is impossible to serve customers or manage a service delivery efficiently without knowing the pursued goals. (Ibid. 273.)

3. MANAGING THE PROCESS OF CONTRACTING OUT

This chapter discusses the process of contracting out in terms of managing the process. The process begins with forming the organizational strategy and making the decision to contract out, the decision is followed with organizing the competitive tendering and finally the contract is negotiated and written. The first phase of the competition is specifying the service that is needed, after careful determination of the service the competitive tendering is organized and finally the lowest or the economically most advantageous tender is rewarded with the contract. (Sutela 2003: 70.)

As the service delivery form is determined in the service strategy, the possible benefits and disadvantages of contracting out must be weighed carefully. In the context of forming the service strategy, mutual principals for contracted out and in-house service deliveries should be formed. As these inner guidelines are written the laws considering contracting out must be included. (Rusanen 2001: 32.) As Hyyryläinen (2004: 110) argues, contracting out is always a radical decision; there are often strong arguments favoring in-house service delivery. The tradition of providing services can be enough of a reason to prevent developing or changing the service delivery. As the strategy of contracting out is being implemented, it will likely face criticism coming from within the employees and from the customers. On the other hand Kanninen (2002: 18) states that the critics should remember that contracting out some public service deliveries does not signify that the public sector is no longer deliver any services. Contracting out service deliveries indicates that the public sector is responding to the demands for doing more with less and increasing efficiency.

A central objective in contracting out public services is to meet the growing demand for the services by increasing the efficiency of the service delivery. Lack of qualified employees in health care is for instance one of the strong arguments behind contracting out public service deliveries. (Kähkönen & Volk 2008: 12–13.) Furthermore public organizations are turning their focus on meeting the citizens' needs, more often by ensuring and managing services delivered by private organizations than employing new

staff. In other words public organizations are changing their focus from rowing to steering. (Osborne & Gaebler 1992: 32–33.)

Additionally Cohen & Eimicke (2008: 43–44) argue that today the public values are changing and bureaucracy is not as functioning as it once was, hence the public is expecting efficiency, effectiveness and higher quality from the public services. One response for the growing demands is contracting out the service delivery. As a consequence of contracting out services, the public organization no longer delivers the service in-house, but it is determining the content, contractor and schedule of the service delivery. (Ibid. 146.) The process of contracting out a public service delivery creates a cycle; starting with the make-or-buy decision, followed by management with contracts, and gradually ending with contractor performance measurement. (Brown & Wilson 2005: 88.)

A public contract manager must be professional and master all the details of the contracting out process. Additionally each decision to contract out must be fundamentally considered. It is crucial that the main objective of contracting out is never forgotten within the organization, the organizational goal is to deliver quality services efficiently with lower costs. (Huque 2005: 79–80.) Public managers must learn how to manage the process of contracting out from the start to finish; in particular the limitations of the law must be understood in order to avoid law suits. (Lane 2000: 146.)

As figure 3 below illustrates, the process of contracting out begins with answering the question how to organize a public service delivery, in-house or contract out. If contracting out is chosen as the form of delivery, the process continues with organizing a competitive tendering. If the service is delivered in-house, the following phase after the make-or-buy decision would be mapping the needed allocation and resources and beginning the actual delivery as soon as possible. The most significant difference is that the competitive tendering is tightly regulated by law as in-house delivery can be organized without regulations.

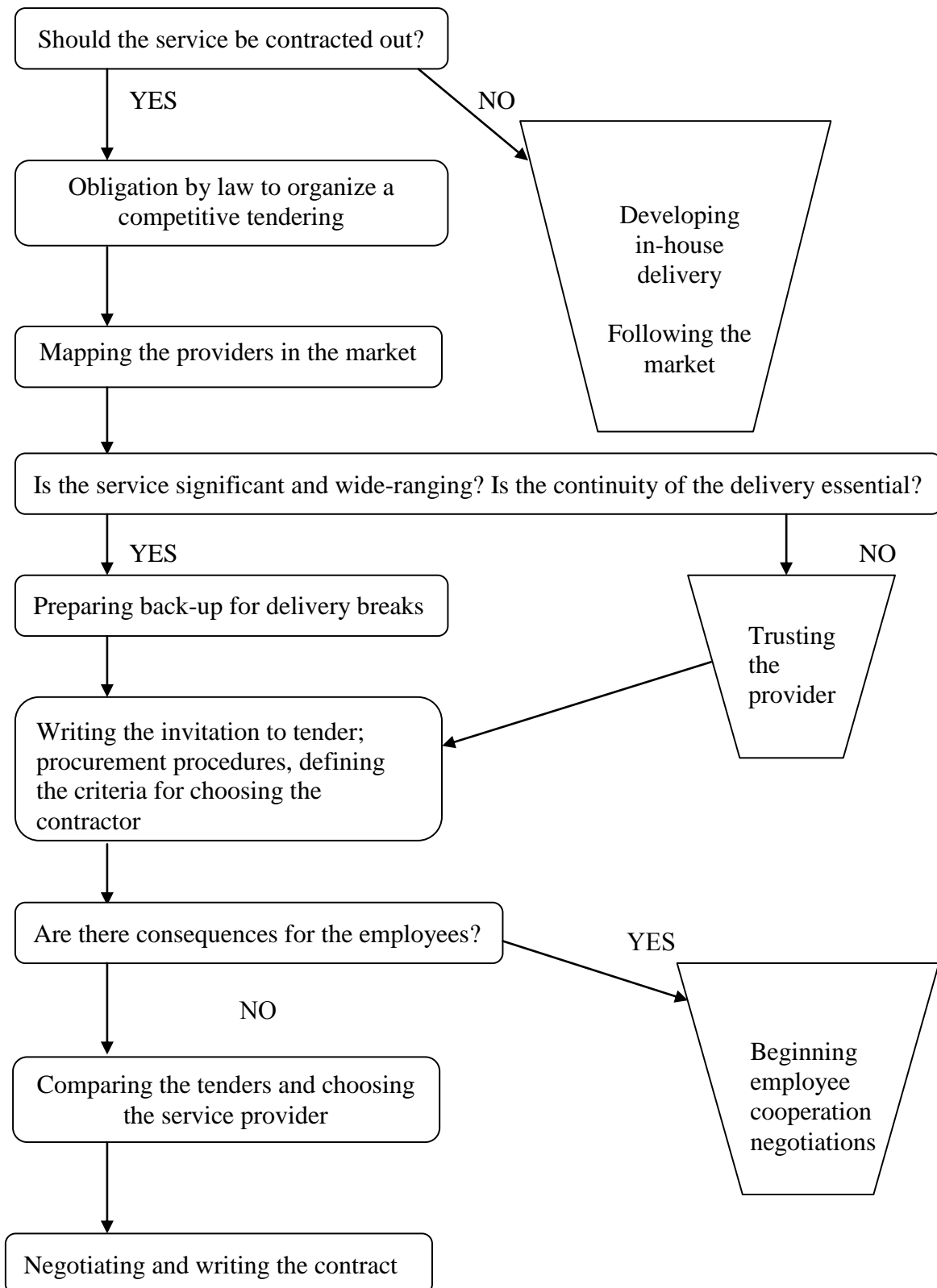


Figure 3. The process of contracting out (modified Rusanen 2001: 59.)

3.1. Reasons for contracting out public services

There are multiple factors contributing to the worldwide success of contracting out public service deliveries as discussed in further chapters of this study, but as Lith (2007: 7) states the original aim for contracting out public service deliveries is to increase efficient use of public funds and provide private organizations the opportunity to deliver more services to the citizens. In the ideal situation the public markets are contributing to economic growth of the country and creating new jobs. Contracting out services will diminish the inefficiency of public services, since contracted out service deliveries are clearly defined and objective oriented. (Lane 2000: 193.) Domberger (1998: 160) further argues that the aim of contracting out services is to renew the way of functioning in public organizations; to increase efficiency in public management and service delivery. If the process of contracting out is successful in its every phase, cost savings should be realized without decreased level of service quality. The final outcome would be better value for the taxpayers.

Public management is in many ways more complex than management in private organizations; a public manager is not always able to interfere in faults that occur, for instance in human resources. Therefore a municipality is not necessarily able to deliver services with as little staff as a private organization is. Contracting out service deliveries is seen as an option for employing new employees. (Valkama & Kallio 2008b: 77–78.) As Risto Raivio, manager of health care service in Lahti, stated in the introduction, at times contracting out is the only option if qualified employees are not available in the market. Lack of in-house expertise can lead to contracting out. It is often more efficient to buy the needed service from an organization that already has experience and the needed knowledge than to hire new employees. (Hyyryläinen 2004: 16–18.)

Furthermore Domberger (1998: 47) presents the positive organizational outcomes of contracting out service deliveries. As the deliverer is separated from the purchaser organization, it allows the purchaser to focus on achieving organizational goals and the deliverer is able to steer its functions into increasingly customer-oriented direction. If the purchaser and the provider of the service delivery are the same organization (in-

house delivery), negative feedback considering the delivery has often little impact. But if a service is contracted out, the quality is carefully monitored and customer-orientation increases. Contracting out services shifts the focus from the service deliverer to the customer. (Domberger 1998: 161.)

A widely supported argument for contracting out is that it can lead to lower costs and better services through competition. (see Lane 2000; Cohen & Eimicke 2008; Kähkönen & Volk 2008; Valkama 2008c: 164.) In the next chapter the desired cost savings are further discussed.

3.1.1. Assumed cost savings

The most obvious goal of contracting out services is to achieve cost savings, although the research data about the cost savings realized through contracting out is quite ambiguous. The estimations of the achieved cost savings vary between 10-30 %. (see Domberger 1998: 51, 163; Lane 2000: 144; Kanninen 2002: 2). It is obvious that the cost saving are not an automatic consequence following the decision to contract out a service delivery. The process of contracting out must be managed professionally in order to achieve cost savings.

Contracting out service deliveries can be expected to create cost, quality and time benefits to a public organization. Significant success in all three areas is not guaranteed, but at least some cost savings, indications of better quality and increase in efficiency can be expected. (Brown & Wilson 2005: 50–51.) Kähkönen & Volk (2008: 23) argue that the costs of the contracting out process are not significant compared with the realized cost savings, that is if the service delivery is defined carefully and the contracts are skillfully managed. Implementing competition by organizing competitive tendering can be expected to create cost savings and relieve the constant pressure to increasing efficiency. (Huque 2005: 69.) Lane (2000: 154) states that one of the undeniable advantages that contracting out services provides is that it focuses the management's attention to the costs and to the procurement process.

Additionally contracting out services adds flexibility to public organizations, since it is not logical to deliver services that are seldom needed and require special expertise in-house. If the demand for the service varies significantly, it is not expedient for a public organization to invest in in-house delivery by hiring staff and arranging premises. Contracting out especially these services adds to cost savings, because of the relatively low competition costs and the effortless procurement process. (Valkama & Kallio 2008b: 78–79.) Kähkönen (2001: 19) specifies that the objective of contracting out and implementing competition in service delivery is to attain cost savings; cost savings through lower production costs, compared with in-house delivery or previous contractor.

However contracting out might incur costs for the purchasing organization. The first time a service delivery is contracted out, the competition process can be expensive since most of the operations involved are not familiar to the staff and have to be learned. The following competition rounds are less costly since routines have formed. (Valkama & Kallio 2008b: 84.) The process of contracting out a public service is not simple or automatic. It brings notable transaction costs along with significant benefits. (Cohen & Eimicke 2008: 143.)

3.1.2. Assumed increased efficiency

As public service managers are given the choice of contracting out service deliveries, they have the opportunity to do more for less. Contracting out public service deliveries increases the flexibility of the delivery process and often adds to the service quality as contractors are aware that their contract will not be renewed if their performance is not adequate. In comparison in-house deliverers possess a secure position regardless of their performance. (Osborne & Gaebler 1992: 35.)

Private organizations often bring benefits to the public sector; private contractors are usually smaller and less bureaucratic. They might see the customers using their services as consumers with money rather than citizens with rights, but this attitude often creates better treatment and responsiveness than customers would receive from a public

organization. (Cohen & Eimicke 2008: 206.) Furthermore Domberger (1998: 162) argues that the specification of the content and the minimum quality levels of the public service deliveries is another benefit gained as contracting out services. As a service delivery is contracted out it has to be carefully specified and its goals determined, this increases the task orientation of the service delivery process.

In order to increase the efficiency in public service deliveries the employees need to be educated adequately. Contracting out service deliveries requires new skills; public employees are to obtain the ability to design contracts, negotiate, monitor and measure performance and evaluate the outcomes of the contracting out process. (Cohen & Eimicke 2008: 145.) If contracting out is new in a municipality, the staff must be educated to master the competitive tendering process. It is crucial that the employees know how to function within the limits of the law. Inadequate expertise in the process of contracting out may lead to unwanted outcomes. The consequences can be law suits, if a provider is discriminated, or delays in the service delivery process. (Rusanen 2001: 32.)

However public organizations should not base the decision of contracting out merely on the assumption that contractors are more efficient in service delivery. This motion should be tested through an objective and analytical comparative process. Services that can be delivered successfully within the public sector should not be automatically contracted out. (Cohen & Eimicke 2008: 31.)

3.2. Can all services be contracted out?

It is impossible to draw a clear line between public service deliveries that can be contracted out and service deliveries that cannot, but the characteristics of service deliveries that have been successfully delivered outside the purchasing organization can be identified. Donahue (2009: 44) states that there are three main characteristics that are required from a service delivery in order to achieve positive outcomes as contracting out public service deliveries. The service delivery should be specific, easy to measure and there must be competition in the market.

Contracting out public services that are not easy to define can cause additional costs in retrospect, since the contract may require modification later or the quality of the service needs to be improved. Problems occur especially in situations where the contractor is not known to be trustworthy or the low cost of the service has been the only qualification for choosing the provider. (Kähkönen 2001: 73.) Donahue (2009: 45) further argues that the content of the contracted out service delivery needs to be specific; otherwise the measurement of the outcomes becomes impossible. The public contract manager needs to be able to determine whether what was ordered is delivered or not. The easier it is to monitor the service delivery and determine the required quality, the better candidate the service delivery is for contracting out.

Blum (2009: 69–70) states that there are multiple issues that need to be considered prior to contracting out a service. First, the market situation is to be mapped, if there is no competition the delivery must remain in-house. Second, the in-house delivery and the level of customer satisfaction are to be reviewed, it may be that the functions can be improved and maintained in-house. Finally, the demand for the service is to be determined. Furthermore Goldsmith (1997: 13–27, quoted in Cohen & Eimicke 2008: 104) argues that a yellow page test should be performed before making the make-or-buy decision. If there are five or more private organizations listed under a particular product or service in the municipality's yellow pages, then that municipality can consider contracting out.

There are situations when contracting out is a considerable option, but sometimes services should be kept public. Cohen & Eimicke (2008: 96–97) highlight two situations where contracting out should be avoided when possible: 1) when a negative impact on capacity that the organization wishes to retain and develop is expected. 2) When the ability to ensure accountability in an area where accountability is critical is reduced.

Several public service deliveries and different functions are suitable for contracting out, but actual governing must remain in-house. Public administration is needed in order to maintain certain rules of behavior; public services must be equally available to all

citizens and non-profitable services must be delivered. The private sector may be more efficient in delivering services and have more organizational flexibility, but the public sector performs better in other functions. Public sector is known to be more successful in for instance ensuring the continuing availability of services. (Osborne & Gaebler 1992: 45.)

The issue of responsibility

The issue of responsibility is not relevant as public services are delivered in-house, since the organization is naturally held responsible, but the issue is more complex when a private organization is delivering the service. Although the purchasing organization does not have much control over the service delivery, it does not mean that the purchasing organization is not responsible for it. (Cohen & Eimicke 2008: 96.)

The issue of responsibility arises when the areas of public and private laws meet as public services are contracted out. Principally the responsibility related to delivering public services cannot be transferred to the contractor with a contract. The responsibility always remains with the purchasing public organization. (Hyyryläinen 2004: 148.) As a service delivery is contracted out, the acts performed by the contractor are public. The purchasing public organization remains responsible for instance for the safety and ethicality of the delivered service. It is worth noting that the standards public organizations are held to are usually higher and different than the standards of the private sector. (Cohen & Eimicke 2008: xii.)

Hyyryläinen (2004: 149) emphasizes that there are always three contract parties. Although the contract is negotiated between the municipality and the service deliverer, the customer cannot be neglected. The contract creates a relationship between the purchaser and the contractor, and between the contractor and the customer. The contractor is responsible to the customer for the service delivery. Hence Cohen & Eimicke (2008: 85) state that when life-and-death issues are involved and extreme levels of accountability are required, contracting out should be avoided.

Contracting out will lead to different principles in the process, the traditional values of the public organizations, such as transparency and openness, may be replaced with business values. The responsibility of informing the public does not cover the private sector as it does the public sector. (Hyyryläinen 2004: 147.) Even though the organizational cultures of public and private organizations may be extremely different, the private organizations delivering public services should be prepared to absorb the sense of public responsibility. (Cohen & Eimicke 2008: 86.)

3.3. Make-or-buy decisions

Since the overall means and policies for delivering services are stated in the service strategy, make-or-buy decisions are made interpreting the service strategy. Make-or-buy decision means choosing between making, i.e. delivering the service in-house, and buying, i.e. contracting out the service delivery. As stated in chapter 2.4 a service strategy is an essential management tool in public service organizations. The make-or-buy decision should arise from the service strategy that is aiming to develop the organization's core competence. (Ibid. 94.)

However contracting out is not solely a strategic decision, since there are some situations where contracting out is so complex that it should not be executed. On the other hand there are situations where contracting out is so easy that it would be bad management not to. Naturally several situations lie in between these two extreme scenarios. One of the most challenging aspects of managing the process of contracting out is to be able to analyze when it is worthwhile. (Ibid. 17.) In many instances, contracting out leads to superior results and the work and cost of establishing functional and solid relations with the contractor are worthwhile. In other cases, the decision to contract out services is political or ideological and it causes more costs than benefits. The make-or-buy decision is an important part of implementing the service strategy, conducting the decision is the first and most significant task of the public contract manager. (Ibid. 91, 143.)

In order to achieve a functional service organization that will also be financially successful, it is crucial to know when to contract out and when to deliver the service in-house. Without contracting out services a public organization may end up hiring more employees that are needed or making other unnecessary investments. On the other hand unsuccessful process of contracting out will waste resources significantly. The decision of contracting out services is the most important part of the contracting process. (Cohen & Eimicke 2008: 91.)

The make-or-buy decision should be based on an analysis of the costs inflicted by in-house service delivery. It is reasonable to contract out, if the results of the analysis indicate that external service delivery creates cost savings. (Domberger 1998: 106.) Prior to contracting out a service delivery, the public service managers should take time to carefully consider the strategic goals of the organization and what the organization is aiming to achieve with contracting out its services. The make-or-buy decision needs to be deliberated carefully, since once a service delivery is contracted out it is often very costly to transfer the delivery back in-house. (Brown & Wilson 2005: 33, 65.)

The decision to contract out public service deliveries should be based on following considerations (Rusanen 2001: 17; Brown & Wilson 2005: 34.):

1. Assessing the current market situation. If there is no competition, the service delivery must remain in-house.
2. Addressing issues with the employees and evaluating the impact on staff.
3. Evaluating the quality and structure of the service delivery, as well as the level of dependency on other service deliveries.
4. Finding the lowest total cost or best value.
5. Recognizing the impact on in-house delivered services.

There are multiple reasons that can contribute to the decision of contracting out a service delivery; a decision within the public organization can be made that in order to be successful in delivering its core function, other service deliveries should be contracted out. Other acknowledged reasons are the hope for reducing costs, pursuit of

increasing quality without higher costs or the need for access to new technology. (Cohen & Eimicke 2008: 6.) As a general rule the core competences should not be contracted out (Brown & Wilson 2005: 36). Brown & Wilson (2005: 40) further argue that a service delivery does not have to be contracted out as a whole. There are multiple companies in the market that are specialized in delivering subservices; they are well qualified candidates for contracting out as the main functions would remain in-house.

As service deliveries are contracted out, the organization should determine what resources are still needed for functioning. It is crucial that the organization maintains the ability and competence to manage with contracts. The problem is that the required management resources are often hard to determine beforehand. As the decision-making process is in motion, it is essential to consider the impact that contracting out will have on the organization. (Cohen & Eimicke 2008: 94.)

As mentioned earlier, all make-or-buy decisions are based on implementing the service strategy. The first step in forming the service strategy is to make an inventory of all the resources that are needed. After the inventory it is easier to define what services can be delivered in-house and what should be contracted out. (Ibid. 101–102.)

Brown & Wilson (2005: 35) assembled a list of issues to be considered in the decision-making process:

Institutional setting:

1. Is this a functional part of our core competences?
2. Does this service need to be provided on a continued basis?
3. Do we have the in-house expertise to provide this service?
4. Do we have the available staff to provide this service?
5. Can we legally contract out this service?

Risks:

1. Would loss of content of this service harm the organization?
2. Would loss of expertise have a negative impact?

3. Is the quality of service delivery a concern?
4. Would the response time to situational problems be reduced?
5. Would current contract performance be negatively impacted?

Goals and objectives:

1. Can the goals for this service be clearly defined?
2. Are the goals for this service long term?
3. Can the achievement of these goals be objectively measured?
4. Are objective measures currently in place for this service?
5. If the goals and objectives are not achieved, will this have a negative impact upon the company?

Contractor evaluation:

1. Are there known external providers for this service?
2. Do the mission and strategic goals of providers align with our organization's mission and strategic goals?
3. Are the providers known to have the capability to provide this service?
4. Has the organization had previous relationships with providers of this service?
5. Are the providers known to deliver high or higher quality services?

The first set of questions determines whether or not the service should be contracted out, the latter questions clarify the aspects that require attention and the possible pitfalls of contracting out public service deliveries. (Brown & Wilson 2005: 36.) Change in the nature of work performed in the organization is an inevitable consequence from contracting out public services. Contracting out may have a positive or negative influence on the organization, or slightly both. Before conducting the make-or-buy decision, the impacts of the decision should be carefully considered and analyzed. (Cohen & Eimicke 2008: 96.)

3.4. Procurement procedures

The process of contracting out is regulated tightly compared to in-house service delivery. The laws and regulations are realized as the competitive tendering is organized. The actual service delivery can be organized as the purchasing organization prefers, regardless of which sector is delivering the service. But as public service deliveries are contracted out, the process of choosing the contractor is far from simple. The regulations add formality to the public procurement processes since the act on public contracts sets rather strict guidelines for organizing the competitive tendering. The law obligates public organizations to organize a competitive tendering, if the estimated value of the procurement is over the set thresholds. (Valkama & Kallio 2008a: 11.)

The most commonly implemented public procurement procedures are open procedure, restricted procedure and negotiated procedure (JulHankL 5 §; Lith 2000: 14.) Other procurement procedures are direct award, in which the organization purchases the service directly from an organization with negotiating a contract without publication of a contract notice or organizing a competitive tendering. Competitive dialogue, if this procurement procedure is implemented the purchasing organization organizes a competitive tendering. After the tendering, a dialogue is conducted with the candidates admitted to that procedure, with the aim of developing at least one suitable alternative for delivering the wanted service. Framework agreement is an agreement that is negotiated with one or more contractors to be valid for certain time. During this time the service can be purchased with prices set in the contract. A competitive tendering is organized. Design contest is a procurement procedure in which the purchasing organization receives plans of how the procurement could be delivered and the most suitable plan is selected by a jury. And finally dynamic purchasing system and electronic auction are electronic processes for organizing a competitive tendering. (JulHankL 5 §.)

In the open procedure the competitive tendering is open to every organization that is interested in preparing a tender. If the restricted procedure is chosen, the purchasing organization can restrict the amount of tenders in advance, for instance by setting certain conditions that have to be met within the organization placing a tender. The

invitations to tender have to be delivered to several organizations; the amount of sent invitations has to be in proportion with the economic scale of the procurement. The negotiated procedure is implemented seldom under special conditions. (JulkHankL 5 §; Lith 2000: 14.) There is always a set deadline for delivering a tender. After the deadline is met, the lowest tender that meets the set criteria is rewarded with the contract. (Cohen & Eimicke 2008: 106.)

When an open procedure is chosen, the maximum amount of tenders is received and there are multiple possible contractors to choose from. A high amount of tenders may bring the contract price down, but it also produces high selection costs since comparing a large amount of tenders is time consuming and toilsome. Restricted procedure is less costly since there are fewer tenders to go through. Additionally the percentage of suitable deliverers will likely be higher; on the down side restricted procedure may encourage higher tender prices as there is less competition involved and it does not encourage new competition within the market. (Domberger 1998: 102.)

There are set thresholds for different procurement types determined in the act on public contracts. There are two thresholds for each procurement type, national and EU. When the estimated value of a procurement is over the national threshold (goods and services 30 000 euro, social and health care services 100 000 euro and public works 150 000 euro) a contract notice must be published and a competitive tendering is to be organized. If the estimated value of the procurement is over the EU threshold (goods and services 137 000 euro, social and health care services 211 000 euro and public works 5 278 000 euro) the contract notice must be published in HILMA and in the official journal of the European Union and a competitive tendering is to be organized. (JulkHankL 15 §, 16 §; Ministry of Employment and the Economy 2011a.) The EU procurement thresholds are updated every two years. (JulkHankL 16 §.) Hence the thresholds, the value of the procurement needs to be calculated before starting the process of contracting out. (JulkHankL 17 §, 18 §, 19 §.) These thresholds are valid when the procurement unit is a municipality in Finland. There are further regulations regarding government procurement units.

Additionally the laws and regulations considering equal opportunities, discrimination and disclosure must be taken into consideration whilst choosing the contractor. The ethical standards, regulations and public law should be part of the whole process of contracting out, from the competitive tendering to the assessment of the outcomes. (Cohen & Eimicke 2008: 31.) Finding the right contractor is not always simple, hence the wide array of regulations. An effective public contract manager is able to function within the law's limits and find the best possible contractor. (Ibid. 105.)

In order to receive as many tenders as possible and increase the competition in the market, the purchasing organization's procurement unit is obligated to publish a prior information notice, contract notice and an invitation to tender. After the tender that will be rewarded with contract is determined, the procurement unit needs to publish the decision and the grounds that the decision is based on. If the procurement's estimated value was over the national threshold the procurement unit must provide the decision and the results of the tendering procedure in writing, including the grounds for the decision, to each organization that placed a tender. When the estimated value of the procurement was over the EU threshold, a contract award notice is to be published in HILMA. (JulkHankL 35 §, 75 §.)

A current trend in the municipalities' procurement processes is cooperation with other municipalities. The municipalities have founded central procurement units with their neighboring municipalities in order to increase the expertise, quality and professionalism in managing the process of contracting out. In addition the municipalities are able to share the costs of the process. (Valkama 2008b: 84.) Characteristic for public procurement procedures is transparency; the procurements are often executed by organizing a competitive tendering, which are open to everyone interested in placing a tender. The municipalities have a responsibility to take advantage of all competition possibilities available in the market. (Valkama & Kallio 2008a: 11.)

3.5. The invitations to tender

The invitations to tender (ITTs) are written before the competitive tendering is organized. The ITT's are published in HILMA in order to inform the service providers about the competitive tendering. They should be as detailed as possible; the minimum level of quality, the wanted form of presenting the price of the tender, and, finally the required investments must be stated clearly. (Brown & Wilson 2005: 118.) Additionally the specific criteria for the contractor selection are determined in the ITT. The foundation for the contract and the relation between the purchaser and the contractor is set in the ITT. (Ibid. 136.) To avoid charges of favoritism and to enable intelligent choices among what might be significantly different proposals; invitations should include a predetermined scoring system so that the organizations placing a tender are aware of how their proposals will be judged. (Cohen & Eimicke 2008: 106).

The law (JulkHankL § 41) provides guidelines for writing the invitation to tender. As mentioned, it needs to be as specific as possible so that the tenders can be compared with each other using the same criteria. According to law an invitation to tender must at least contain:

- 1) clear definition about the content of the procurement and specification of quality requirements;
- 2) reference to the published contract notice;
- 3) a deadline for delivering tenders;
- 4) an address, to which the tenders are to be delivered;
- 5) a language or languages in which the tenders are accepted;
- 6) a list of the possible economical, technical or professional demands for the organizations placing a tender and a list of documents that the tendering organization needs to provide;

- 7) the criteria for choosing the contractor, and, if the economical advantageousness is set as criterion, the relative emphasis of different aspects; and finally
- 8) the period the placed tenders are valid for.
- 9) The law obligates that the procurement is to be purchased as affordable as possible and the tender that is economically most advantageous should be accepted. (Rusanen 2001: 34.)

The criteria set for rewarding a tender with the contract can be economically most advantageous or simply the lowest tender. Criteria for choosing the economically most advantageous tender can be for instance price, quality (what kind of quality needs to be explained), technical merits and environmental issues. (Rusanen 2001: 34.) The economically most advantageousness as criterion is often stressed, for instance if the maximum points for the tender are 100, the lowest price is rewarded with 60 points and the tender that meets the quality requirement most accurately is rewarded with 40 points. The other tenders are scored relatively in comparison with the lowest price and highest quality. The tender that gets the highest overall scores is rewarded with the contract.

The criteria and the emphases specified in the ITT have a central position as the winner of the competitive tendering is determined. The demand for certain level of quality is determined in the invitation. If most tenders meet the set criteria, low price is the main reason for selecting a certain contractor. Often the quality is invariable at the minimum requirement level. The relation between quality and price can be stressed in different ways in the competition process; the weight of the contract price varies between 45% and 90 %. Often the price weighs more as criterion simply because it is much easier to determine than quality; in addition the quality measurement process is seen as toilsome. (Valkama & Kallio 2008b: 80–81.) If the low price is excessively stressed in the competitive tendering, exceptionally low tenders should be carefully examined as the low price may indicate insufficient quality or poor resources. (Huque 2005: 78.) Furthermore Lith (2000: 24) states that there are several concerns considering the fact that often the low price seems to be the main (at times only) criterion set in the ITT. The

professional organizations are excluded for the competition as expensive and the organization that is rewarded with the contract usually delivers with less work and investments. This development may lead to poor quality and mistakes.

All the criteria applied for choosing the contractor must be published in the ITTs, if the ITT and the published contract notice differ in content, what was written in the notice is enforced. (JulkHankL 40 §, 41 §). In order to set the criteria for service quality in advance in the ITT, the contract manager must be familiar with the service delivery content or have access to adequate information. The aim is to buy services that contain the best relation between price and quality. (Rusanen 2001: 20–21.) There is pressure to choose the tender that offers the service at the lowest cost, but the quality of the service should at least be considered as one of the grounds in the competition. (Hyyryläinen 2004: 145.)

The question of service quality is rather ambiguous. Quality requirements are hard to define in the ITTs and in addition the quality of the service is challenging to measure after the service delivery is contracted out. In municipalities the minimum requirements for service quality often come from political leaders. The public organization must acknowledge these requirements in the ITTs. (Rusanen 2001: 35.) The invitation will determine the service that is needed, but it does not clarify how it should be delivered. Those interested in placing a tender must make their proposal in what they think is the best approach, cost and level of performance for the particular service delivery. (Cohen & Eimicke 2008: 106.) Huque (2005: 79) emphasizes that even if the deliverer is allowed to determine the way of delivering the service, they should never be allowed to determine the content of the service; as the purchaser clearly states what is wanted, the outcomes of contracting out are more likely to be positive.

3.6. Organizing the competitive tendering

The competitive tendering is part of the procurement procedure, it means that the purchasing organization's procurement unit receives tenders (based on the ITT) and

compares the tenders with each other. After the comparison the organization, that placed the tender that meets the criteria best, is rewarded with the contract.

The requirement of organizing a competitive tendering before writing the contract is founded on the idea that public services must be delivered as cost effectively as possible. The simple logic behind the idea of competition is that it lowers the contract prices; hence municipalities aim to maintain highly competitive market situations. (Karisto & Lohivesi 2007: 27.) Hyyryläinen (2004: 37) further states that there are two central motives for competition; either the objective is simply to offer private organizations more opportunities to deliver contracted out services, or, the objective is to get the public service producers to shape up in order to match the private competition. Its (contracting out) distinctive feature is what economists refer as to *ex ante* competition: that is competition for the market instead of competition in it (Domberger 1998: 159).

Organizing a competitive tender was enacted as an obligatory phase of the contracting out process in 1994. After the law was written, it was no longer possible to favor contractors in the competitive tendering. (Sutela 2003: 70.) Competition in service delivery is expected to have an overall impact of decreasing costs and therefore increasing the efficiency of the services. These are the intended outcomes of contracting out services. (Kähkönen & Volk 2008: 10.) Problems occur if the received tenders are not similar with each other. (Hyyryläinen 2004: 126.) The invitations for tender should be carefully prepared and extremely specific; no room for misunderstandings should be left. If the invitation leaves room for interpretation, the tenders are not similar with each other which make the comparison of the tenders extremely challenging if not impossible. (Lith 2000: 25.)

Osborne & Gaebler (1992: 79–80) states that competition between different service deliverers decreases the prices in the market, encourages customer-orientation and improves the quality of service deliveries. No organization enjoys the competition, but it drives them to become more successful. Increased competition in delivering public services is no panacea, but it most definitely helps achieving more for less. Kähkönen &

Volk (2008: 13) further argue that the objective of increasing competition in service deliveries is to realize cost savings, but the implementation of competition is extremely demanding. Determining the wanted quality and content of the service in the invitation for tender is challenging. Crucial factors in successful competition are competent purchaser and deliverer, and a competitive market situation.

Competitive tendering encourages innovative thinking, as in comparison a public monopoly does not allow much creativity. A competitive situation changes everything in an organization; poor quality or high prices are no longer tolerated and the organization must improve its delivery in order to exist. (Osborne & Gaebler 1992: 83–84.)

After a public service is contracted out it is crucial that competitive market situation or a threat to competition remains. Competition motivates to produce better quality services. (Kanninen 2002: 28.) Valkama & Kallio (2008b: 83) further argues that the achieved cost savings depend on the current market situation; the amount of new bidders and competition in the market have a significant role as it comes to achieving cost savings through contracting out public services. In addition Lith (2000: 21) states that the municipalities should invest in managing the competitive tendering and knowing the requirements of the law, since nearly all law suits and complaints to the market Court are caused by poorly managed competitive tendering.

3.7. Problems in the process of contracting out

The process of contracting out public service deliveries has positive outcomes in most cases, but there are certain conditions that are essential for its success. Especially strict restrictions of the act on public contracts inflict problems within the process. In this chapter the most common pitfalls in managing the process contracting out are discussed briefly.

3.7.1. Problems in competitive tendering

At times competition does not have the influence that was hoped. It is possible that competition decreases the amount of service deliverers in the market and creates new monopolies. Competition does not necessarily produce new service deliverers; it can assist centralization of the service delivery to already existing organizations. (Sutela 2003: 229.) Kähkönen & Volk (2008: 21, 24) further states that the competitive tendering will fail to meet its purpose, if there are not enough private organizations taking part in it. Hence monopolies maintain their positions and cost savings are not realized. This is an actual threat in rural areas, where there is not adequate demand for several service deliverers in the same field. Problems may occur in the larger cities as well if for instance big multinational companies are dominating the market. Maintaining a public deliverer is one option for sustaining competition in the market.

Private organizations do not deliver all services that the public sector provides to citizens and for some services competitive markets exist only in certain parts of the country. These issues inflict on the competitive tendering. The absence of tenders in a competition is a strong indicator that contracting out should be reconsidered. It is dangerous to proceed with the process of contracting out if there is not enough competition, no organization should be provided with a monopoly position. A monopoly organization can raise prices and even withhold service. (Cohen & Eimicke 2008: 129.)

Managing a competitive tendering is challenging, far from simple. The criteria must be considered carefully since if the low price is the only factor in the selection process, the contractors may be encouraged to reduce the price with unwanted consequences or the contractors delivering high quality services may place low tenders and lift the price afterwards. (Domberger 1998: 164.) Okko, Björkroth, Koponen, Lehtonen & Pelkonen (2007: 119) further argue that a potential threat, as the competition in the market and the number of companies delivering services increases, is that the quality of delivered services begins to vary considerably. This would lead to higher costs in quality supervision and add pressure to contractor selection.

At times private organizations place a low tender in order to get the contract in the first place and then increase the price later with additional costs or in the following contract. Contracting out when there is not enough competition in the market is dangerous, as it allows the contractor to develop a monopoly and inflate prices. (Osborne & Gaebler 1992: 88.) It has been acknowledged that the ideological preference for privatization may in some cases lead to contracting out a service even in noncompetitive markets. (Cohen & Eimicke 2008: 7.)

The pressure of doing more with less is always present in public organizations. Therefore contract managers are often tempted to choose the contractor solely on the basis of low costs, since the costs are always carefully measured. This is a frightening prospect in for instance health care services; the lowest cost usually implements the poorest care. To avoid unwanted consequences, other aspects than cost should also be considered as criteria, for instance the past success in delivering quality services should count. (Ibid. 114–115.)

3.7.2. Criticism of contracting out

The idea of contracting out public services has been critiqued of hollowing out public organizations; hollowing out meaning losses in in-house expertise, corporate memory and the bases for innovation. The worst-case scenario is that the purchasing organization becomes an empty shell, as all its core functions are contracted out. On the other hand multiple “hollow” public organizations have become successful as contract management organizations. (Domberger 1998: 69–70.)

Cohen & Eimicke (2008: 95) state that as a result of contracting out, the organization may become too reliant on others. Over time the contractors may become the purchasing organization's competition, with the help of resources provided by the organization that ordered the service in the first place. One additional argument is that contracting out is a tradeoff between lower production costs (provided the supplier possesses lower cost technology) and higher monitoring costs. (Lewis & Sappington 1991, quoted in Kakabadse & Kakabadse 2000: 701).

Contracting out public service deliveries does not only solve problems, it creates them as well (Cohen & Eimicke 2008: 125). Contracting out services often creates cost savings and is beneficial, but the process of contracting out may bring about additional costs and problems to the purchasing organization. Costs are for instance inflicted from educating the employees and from the organizational change. (Huque 2005: 71.) At times as a low total cost is presented in the contractor's original tender, additional costs that are reported after signing appear to be significant. The management of the contracting out process may require more resources that were initially calculated, causing additional costs to the contracting out. (Brown & Wilson 2005: 65.)

The intended outcomes and problems of contracting out services in private organizations are similar to the ones in public organizations. In private organizations services are contracted out in hopes of achieving immediate cost savings and improving the flexibility of the organization. On the other hand the dependence of the contractors is seen as downside that decreases the competitiveness of the organization. (Sutela 2003: 138.)

4. MANAGING SERVICES WITH CONTRACTS

As the competitive tendering is concluded and contractor is chosen, the public service manager becomes a contract manager. A contract manager, who negotiates the contract terms, creates the means for measuring contractor performance and communicates with the contractor. Contracting out a public service delivery should be considered as a process, which consists of clearly defined steps, from strategizing to the ending of the contract period. Each phase of the process is to be managed and measured carefully. (Brown & Wilson 2005: 29.) Management is the key to successful contracting out. As Huque (2005: 81) states poor contract management results as increased costs, unsatisfying service quality and low customer satisfaction. In other words the success of the whole process is depended on its management. Lane (2000: 144) further states that successful contracting out requires a reliance upon managers, whose position becomes very strong.

According to Brown & Wilson (2005: 29) the main challenges in contracting out services are to find a suitable contractor and manage the relationship with the chosen contractor successfully. Managing with contracts demands expertise in multiple fields; the public contract manager must obtain or have access to knowledge in multiple areas, for instance communicational procedures, law issues and above all the specific content of the service delivery. (Ibid. 145.) Managing with contracts is a complex and long process which requires skill, time and effort. In some organizations active management ends as the contract is signed, although at that point the contract manager's work actually begins. (Osborne & Gaebler 1992: 87.)

Public management is bound to become more efficient as service deliveries are contracted out, since the contract manager has a clearer set of tasks and responsibilities than a public service manager. As the contract manager concentrates on monitoring the service delivery, the quality and efficiency will likely improve. (Domberger 1998: 161.) As the purchaser of a service delivery, the public organization should concentrate on two main objectives: minimizing costs and maximizing the quantity and quality of the

contracted out service. In order to successfully pursue these goals the contract manager must be fully committed. (Lane 2000: 155.)

4.1. Contracts

Negotiating skills are crucial as the contract is written, since the benefits of contracting out cannot be realized if the contract is not specific enough or the conditions are poor from the purchasing organizations perspective. The pursued type of the contract and the relationship with the service deliverer depend on the content of contracted out service delivery and the contract period. At times a tight relationship and regular communication with the contractor are essential and at times a less formal partnership can be more functional. The contract manager must be aware of the importance of the contract; the title contract manager does stand for something.

In this area managing services with contracts differs from service management the most, since as contracts are the most important management tool for a public contract manager; a public service manager can be successful without ever having to negotiate a contract.

Generally a contract is understood as a reciprocal legal act that establishes changes or overrules rights and responsibilities (Sutela 2003: 133). Contracts, by their very nature, are voluntary as they would not be signed unless they represent the interest of both signing parties (Lane 2000: 161). In its specific context, a contract must specify questions related to the “what”, “when”, “where” and “how” (Lindholst & Bogetoft 2011: 2). Typically, contracting in public management focuses upon the provision of goods and services, i.e. allocative contracts (Lane 2000: 194).

The contract is written as a result of negotiating the contract terms. The purchaser seeks to have more services delivered for less funds and the contractor pursues to deliverer less and receive more. The outcome of the contract negotiations is more or less a compromise between the two objectives. (Ibid. 153.) The contract agreement should be

carefully written and considered; it should be specific enough to provide the wanted service delivery, but flexible enough to allow modification if the need for the service changes. (Cohen & Eimicke 2008: 4.) A contract is meant to be interpreted as it has been written. Keeping this in mind, a formally strict contract is not always applied as strictly as it has been written down. Gradually, as the relationship between the contract parties develops, the contract can become less specified; or if the trust between the parties is hurt, even stricter. (Hyyryläinen 2004: 39.)

A contract typically includes information about (Sutela 2003: 153; Cohen & Eimicke 2008: 4):

- The purpose and background of the contract
- The definition of the service being delivered
- The amount of the service being provided
- Price and schedule
- Quality and performance measurement systems
- Period of validity and cancellation

The characteristics listed above are the building blocks of contracts, determining the content of the contracted out service delivery. Even though there are certain fields that are often included to all contracts, every contract should be assembled specifically to meet the needs of each unique situation. (Sutela 2003: 153.) Levin & Tandelis (2010: 513–514) further argue that a contract should specify the elements of time and performance; for instance if the contracted out service would be landscaping, the contract could specify performance by determining the frequency for trimming certain trees and bushes. Alternatively, the contract could specify that the contractor spends forty hours a week providing landscaping services as directed by the principal. This example set by Levin & Tadelis (2010: 513–514) can be adapted to multiple similar scenarios by setting strict guidelines for contractor performance. A general guideline for writing contracts is that the contract should rather be too detailed and strict, than too ambiguous. According to Vuori (2004: 3) the contractor delivers only what is written in the contract; as services are delivered in-house, the employees often do more. Hence the

contracts must be specific and contain every single detail that is wanted from the contracted out service delivery.

Levin & Tadelis (2010: 514) further argue that a contract should include a specification of the wanted quality standards or time requirement, but never both. The time that is required in delivering certain quality cannot be determined before the execution of the service delivery and additionally if both are specified the contractor has no motivation to deliver high quality with less resources and time. Sutela (2003: 153) states that the main issues in contracting out public services, how to measure the performance level on an outside contractor and what are the sanctions that follow from delivering poor quality services, should be determined in the contract, specific criteria in the contract facilitates the measurement process.

The element of risk should be considered as the contract terms are negotiated; the less the parties are willing to risk, the detailed the contract should be. On the other hand if the contract parties trust each other, the contract can be less detailed. But if the estimated contract value is high, for instance the contract period is long; the contract should be detailed without exceptions. (Kähkönen 2001: 20.) Furthermore since contracting out includes risks for both contract parties, the contract must determine how the risks are shared between the purchasing organization and the contractor. (Yang, Hsiesh & Li 2010: 90.) The standard procedure in economics is that the contract party taking more risks, gains economical profits by doing so (Hodge 2004 quoted in Yang et al. 2010: 90).

When a public service delivery is contracted out for the first time the context and the language of the contract are central. All of the possible scenarios that may arise should be negotiated, although predicting can be challenging when the service has previously been delivered in-house. On the other hand the contract should be flexible so that it permits performing all the required tasks. One way of solving this problem is to leave the original contract open to later specifications, as the organization's knowledge of contracting out services increases over time. (Cohen & Eimicke 2008: 127.) The first time a service delivery is contracted out, it is hard to determine how much resources are

required and what will be the final cost of the service delivery. Often the process of delivering a public service includes tasks that the private organization has not previously performed; therefore the cost for these tasks cannot be known in advance. This, together with other differences between the public and private organizations, can contribute to underestimating or overestimating the cost of the delivery in the contract. (Cohen & Eimicke 2008: 134.)

The process of carefully writing the contract adds to the (advance) costs of contracting out, but a detailed contract will likely contribute to cost savings as the services are being delivered outside of the public organization. If the contract is too ambiguous costly misunderstandings may occur. (Kähkönen 2001: 20.) Lindholm & Bogetoft (2011: 22) further argue that detailed and complete contracts (that include monitoring and enforcement instruments), are perceived as a way of reducing the risk of opportunism and handling uncertainty arising from contingencies.

4.2. Contract periods

The main rule is that the more often the competitive tendering for the service delivery is held the more competition there is to lower the service prices. For this reason the contract periods are often relatively short, varying from one to three years. On the other hand short contract periods increase competition costs. With longer contract periods other costs may arise, such as supervision and quality control costs. (Hyyryläinen 2004: 126.) As the service deliveries first are contracted out, short contract periods may seem attractive in order to encourage competition in the market. But in the long run ensuring the availability of the service becomes more important and as partnerships evolve, long contract periods are preferred. (Lane 2000: 12.)

Negotiating, signing and implementing a contract results in so called transaction costs. If the content of the service delivery is easy to define and the contract period is short, the transaction costs remain low; in proportion complex service deliveries inflict higher

costs. Short contract periods should be implemented when the transaction costs are low, long contract periods should be favored as transaction costs are higher. (Ibid. 133.)

There is a conflict of interests in defining the contract period. The purchasing organization needs to choose between maintaining competition in the market and contributing to service quality. Short contract periods increase competition in the market, as long contract periods encourage the deliverer to make investments and allow enough time to improve the functionality of the service delivery process. In the private sector long contract periods and partnerships have already displaced the continuous competition. (Kähkönen & Volk 2008: 26.)

In short term shorter contract periods are increasing efficiency, but the relation between the contractor and the purchaser remains superficial, if the contractor changes often. In long term this may have a negative impact on the achieved efficiency since the contractor and its employees do not have enough time to form trusting relations with the purchaser and the customers. (Ibid. 26–27.) Lith (2000: 26) further argues that short contract periods stand in the way of developing the service and cause difficulties in recruiting personnel. Short contract periods and changing contractors will add to the total costs in cases where the service delivery requires constant cooperation between the purchaser, deliverer and the customer. (Kähkönen 2001: 73.)

The length of the contract period is essential, since a service delivery often requires notable and expensive investments. This excludes smaller private organizations from the competitive tendering, if they do not have the resources to make required investments for delivering the service. Long contracts make investing more sensible even for smaller organizations. (Hyryläinen 2004: 116.) Domberger (1998: 170) states that depending on the circumstances an optimal contract period is three to seven years. The contract period has to be long enough to allow the contractor to become familiar with the functions and improve quality of the service delivery, but short enough to encourage competition in the market.

4.3. Managing with contracts

As mentioned before, managing with the contracts is the fact that makes public service management and the management of contracted out services so different. The contract manager must be aware of the fact that the contract is the most important management tool in the field of contract management. With careful consideration as the contract is negotiated and written, pitfalls can be avoided.

Contracting out public service deliveries creates a need for renewing the traditional public management (Sutela 2003: 87). Contracting out public service deliveries introduces new challenges for public managers; it is a difficult challenge to manage staff members and managers who work in a separate private organization. (Cohen & Eimicke 2008: 143.) Hence contract managers must obtain a large scale of different skills. He/she must know how to write and negotiate the contracts, organize competitive tendering and master the measurement systems of contractor performance, without disregarding the essential role of communication with the contractor. (Ibid. 92.)

Contract management is a critical skill for all modern public managers. Especially the two-way sharing of information between the contract parties must be functional in order to achieve success in managing with contracts. Public contract managers have a unique burden; along with the usual concerns of trust and reliability of the other party, additionally public values, such as transparency and accountability, must be protected. (Ibid. xi–xiii.)

Becoming an efficient contract manager requires learning how to (Ibid. 123.):

- Find out what their contractors are doing
- Develop and implement systems of contractor incentives
- Get a fair price for services
- Develop the skills needed to negotiate performance based contracts.

Managing with contracts is forming different kinds of contract relations, maintaining them, adapting the contracts and ending them when needed. Managing with contracts has to be comprehensive and the different demands of each party have to be taken into consideration. Successful management is a valuable asset to the purchasing organizations. (Hyyryläinen 2004: 23–25.)

Cohen & Eimicke (2008: 116) states that today the main challenge in contract management is less about finding the right contractor; it is more about ensuring that the contractors deliver quality services with the lowest possible price. Brown & Wilson (2005: 26) further states that the purchasing organization should treat the contractors as equal partners. A functioning relation with the contractor is crucially important in order to achieve success in contracting out public service deliveries. Managing this relation is one of the most important aspects in managing with contracts.

Kelman (2009: 174) determines the tasks of a public contract manager. Since supervising the employees' day-to-day basis is performed by the contractor's management, the public contract manager should concentrate on executive type functions such as planning, strategy forming and performance measurement. Cohen & Eimicke (2008: 17) further state that managing a contractor's work has several different elements. Managing with contracts requires:

- strategic planning
- leadership
- human resource management
- financial investment
- financial allocation and control
- work process analysis improvement
- performance measurement
- ensuring that ethical standards are followed
- reporting and control that facilitates contractor accountability

One significant challenge in managing with contracts is that the manager has to attend to the changes in personnel and in-house operations caused by contracting out services. Contracting out may create negative feelings among staff, therefore information needs to be shared openly with the employees and the managers must give them time to accept the changes. (Cohen & Eimicke 2008: 130.) A fear of layoffs is a natural consequence from a decision to contract out a service delivery. The fear can be soothed with adding a clause to the contract stating that the contractor will employ some or all of the current staff. (Cohen & Eimicke 2008: 139.)

Osborne & Gaebler (1992: 38) argue that public employees are not victims of contracting out, the amount of jobs for instance in health care does not decrease, the jobs just simply shift to the private sector. In fact the employees may benefit from the change as the often bureaucratic public organization changes into a private organization where employees have a clear mission and less rules and regulations to follow.

How contract managers are able to negotiate and write adequate contracts that ensure successful service deliveries? The performance of the public contract manager is the Achille's heel of contracting out public services. (Lane 2000: 153.) Lane further suggests that the contract manager's contract of employment should be written for a short contract period or at least be a performance contract, which can be dissolved if necessary. This suggestion is reasonable, since so much relies on professional management as services are contracted out. (Ibid. 151)

A public contract manager must also be able to monitor and evaluate the contractor's work. Formal program evaluation methods are needed, but informal feedback is just as important. The contract manager should establish informal communication connections with the contractor's staff in order to be informed how the service delivery is performed in practice. In addition the ability to perform or at least understand cost effectiveness analysis is important, since the price of the delivered service is always negotiable. The manager must analyze overall success of the service delivery as the contract period ends. (Cohen & Eimicke 2008: 124–125.) Brown & Wilson (2005: 66) state that the contract manager ought to implement preventive management means by laying out a

schedule for regular meetings with the contractor. Tight meeting schedule with the contractor will encourage open communication about emerging problems and increase the flexibility of the relation.

It also is crucial that the contract manager has an understanding about the content of the service delivery that is contracted out. Only after determining the work that is done carefully, the manager is able determine which organization is qualified enough to deliver the service. A manager should possess or have access to operational knowledge about the service that is contracted out. (Cohen & Eimicke 2008: 124.) Contract management is demanding; it requires the same set of skills as internal management with additional requirement of managing inter-organizational relations. Therefore the management capacity of the purchasing organization must be high. (Ibid. 125.)

4.4. Communication in contract management

As discussed in the previous chapters, functional communication is the key for delivering efficient services, whether in-house or contracted out. New communication challenges arise as public services are contracted out, the manager must be able to find means to maintain honest and open communication with the delivering organization. Compared to communicating with in-house employees, establishing functional communication with the contractor may be challenging.

Communication between the contract manager in the purchasing organization and the managers in the contractor organization is crucial in order to achieve a successful contracting process. If the communication contact is not working, it may result higher costs and misunderstandings, since poor communication may lead to poorly defined tasks and unexpected outcomes. Therefore communication should be frequent and both formal and informal. Frequent contact with the contractor should be ensured in contract terms. It should be noted that most organizations are reluctant to share their problems with their clients; honesty in the communication should be strongly encouraged. (Cohen & Eimicke 2008: 130–31.)

The most important form of communication is the particular and accurate directions the purchasing organization gives to the contractor. What is not carefully defined cannot be delivered. Inadequate directions may lead to conflicts or inadequate goals and knowledge gaps. (Cohen & Eimicke 2008: 131.) Kähkönen & Volk (2008: 21) further argue that problems with inadequate communication are easily highlighted in the context of public service delivery. There are three parties (customer, contractor and purchaser) involved that need to receive information about the delivery process, quality and cost of the service. If for instance the contractor has more information than the purchaser, the contractor can take advantage of the situation and function against the purchaser's best interest. This places demands for specified contracts, including especially sharing of the risks.

In order to achieve all possible benefits of contracting out the purchasing organization must have an understanding of its own objectives (service strategy) and the contractor's aims. A consensus in objectives for the service delivery is a prerequisite for a successful partnership with the contractor. (Brown & Wilson 2005: 65.)

4.5. Measuring contractor performance

Since you cannot manage something you cannot measure (Cohen & Eimicke 2008: 136), measuring the performance and quality of a service delivery, whether it is delivered in-house or contracted out, is essential in terms of successful management. Domberger (1998: 164–165) states that measuring performance is a positive consequence from contracting out public service deliveries. Measuring in-house performance is not common in public organizations, contractors are monitored more closely and the quality of the service is thus ensured. Performance measurement additionally increases the accountability of the service delivery.

Contracting out public services is beneficial in terms of accountability in two perspectives. First, the specification of the service delivery provides information of

current service levels and thus increases accountability. Second, as performance measurement is implemented, the measurement has likely been insignificant prior to contracting. Contracting out service deliveries improves the accountability in public organizations. (Domberger 1998: 172.)

Service performance is a multidimensional construct that is hard to measure. Nonetheless, three main areas that are measured can be named: efficiency, economy (cost savings) and service quality (Yang et al. 2010: 89). Performance measurement is crucially important in determining the success of a contracted out service delivery. It is important to create a measurement system that will provide objective information about the contractor performance, and thereby provide tools for updating the contract. Additionally measuring contractor performance effectively ensures the accountability of results in calculating whether or not hoped outcomes were achieved. If a measurement system is not created and is not functional when the service delivery begins, contract management becomes extremely challenging. The outcomes, performance and the quality of the service delivery should at least be measured. (Brown & Wilson 2005: 64, 141.) According to Domberger (1998: 65) the main reason why measuring contractor performance is important is the highlighted need for accountability as public services are contracted out.

Determining what is measured is essential, if for instance in health care services the quantity of treated patients is the criterion for determining what a successful service is, the quality of the service will likely reduce. (Cohen & Eimicke 2008: 54.) Yang et al. (2010: 84) further argue that the contract manager's mindset will gradually become more alike with private contract managers as the implementation of business-like reforms, such as contracting out and privatization of public services, further increases. The criteria for measuring contractor performance will for instance become similar to what is implemented in the private sector.

It is crucial that the contract manager is thoroughly and accurately informed about contractor performance and possible issues that occur. Only then the contract manager is able to work efficiently. The performance measurement system must be adapted to

the special characteristics of every organization and its service deliveries. It must be allowed to evolve, but it should include at least specific indicators, deadlines and frequent mandatory discussions. One of the fundamental issues with performance measurement is that often the people executing the measuring are also being measured. Auditing the contractor performance is not a standard in public organizations. Usually the cost of auditing is not included in the final cost of the contract, it should be an automatic procedure and necessary inter-organizational transaction cost. (Cohen & Eimicke 2008: 136–137.)

The contractor should be obligated to deliver reports about its functioning frequently during the contract period so that the purchasing organization is able to monitor the quality of the service delivery. The purchasing organization should appoint a person in charge of quality monitoring in the ITT. (Rusanen 2001: 36.) The data collected in the measurement process should be used to develop the cooperation and implement changes if necessary. (Cohen & Eimicke 2008: 137.)

Critics argue that the often diminished price of contracted out services automatically indicates diminished quality. This statement is difficult to verify, since the experienced quality of the service delivery varies individually between the customers. Additionally the quality of the service is seldom closely measured before contracting out; this makes reliable comparison of the quality between in-house and contracted out services impossible. Public managers become often more sensitive to quality issues after the service delivery is contracted out, the contractor is monitored more closely than in-house delivery. (Domberger 1998: 43–44.)

Performance measurement can be difficult, since a private organization is likely to have an organizational culture that does not understand the responsibilities of public trust and there are differing principles in transparency in the private sector. The private organization might not be willing to provide information as openly that is accustomed in public organizations. (Cohen & Eimicke 2008: 51, 85.) On the other hand feedback from the customers can be collected and used as the bases for developing the service delivery during the contract period. (Rusanen 2001: 35.)

The contract manager's personal attitude towards contracting out public services may influence the outcomes of contractor performance measurement. Often a public contract manager is not critical as contractor performance is measured, since canceling the decision to contract out is extremely toilsome and returning to in-house delivery is not simple. The contract managers have self-interest not to be too critical. (Yang et al. 2010: 83–84.) The success of the delivered service can be in some cases extremely difficult to measure. The special features and the long timeframe of the public service deliveries, for instance education and environment protection, make quality control a challenging and lengthy process. (Cohen & Eimicke 2008: 50–51.)

Huque (2005: 79) states that the performance measurement should in no circumstances mean that the contractor reports and the purchaser monitors by reading the reports; the contractor is not an objective source for auditing. The measurement is to be performed by the purchasing organization or by an outsider. Domberger (1998: 46) further argues that the measurement system itself ought to improve quality. Since contractors are aware that their performance is being measured, it is worthwhile to deliver high quality services.

4.6. Problems in managing with contracts

As there are issues with managing in-house delivered services, managing contracted out service deliveries is not problematic, since contracting out places high demands on public managers and is strictly regulated. In this chapter the most common pitfalls of managing with contracts are presented.

Contracting out public service deliveries is not a panacea; it has at times failed. However the organization can learn from its prior mistakes; negative contracting experiences should be considered while the service strategy is formed, earlier mistakes should never be repeated. (Kanninen 2002: 22.) Vuori (2004: 2) further states that there are several issues related to contracting out public service deliveries; negotiating and

writing the contract may cause problems if the content of the contract is not specific enough, the regulations and bureaucracy in the process of contracting out may cause delays in the service delivery, poor communication and poor contract management will most definitely create problems, inadequate measurement procedures will make the evaluation of the process impossible, and, finally if a contracting out process fails the media and politicians will notice it and the public opposition to contracting out will likely increase.

Freeman & Minow (2009: 3–5) further argue that if the contract has not been written carefully and terms have not been negotiated completely, problems will arise. If there is no consensus between the purchaser and the contractor about the content and method of the service delivery, the outcomes of contracting out will not be what were expected. Lack of expertise in contract management or simply lack of contract management will increase the risk of failure. There is a risk that the traditional public values, such as transparency and equality, are in danger as services are delivered by the private sector. The same laws and regulations that consider public organizations and their functions do not obligate private organizations.

There have been accusations that municipalities contracting out their services are not always able to forget their authority, thus fail to treat the contractors as an equal partners. The relation between the purchaser and the contractor should be an equal partnership. (Lith 2000: 20.) It may also occur that for some unexpected reason the contractor fails to deliver what was agreed upon, to avoid these situations crucial risk analysis is to be conducted before contracting out a service delivery. (Brown & Wilson 2005: 237.)

According to Domberger (1998: 110), there are two main areas where problems in contracting out public service deliveries culminate, trust and control. Trust becomes an issue, since the purchasing organization and the contractor often have differing objectives for the delivered service, fear of non-cooperation or lack of communication are often justified. As a public service is contracted out, the purchasing organization loses control over the service delivery process; control can be maintained with

monitoring and measuring, but many organizations feel that they cannot control the outcome of the service delivery.

There is a risk that the private organization delivering the service gives the work low priority, the contractor has employed poorly trained staff, inadequate numbers of staff members or has poor equipment. The contractor may realize that the contract is not going to be renewed, but they are content with the one contract term they have. In problem situations, the purchasing organization can try to meet with the contractor and even pose threats of punishment in hopes of better service delivery. In these cases the contract manager must be able to admit that something they are responsible for has failed. Contracts should always include sanctions for poor performance, articles demanding certain level of resources and cancellation clauses that enable the reversal of the contract if the performance level is extremely poor. A contract manager should always let the contractor know if they are not satisfied with their performance. (Cohen & Wilson 2008: 132–33.) Unsuccessful contract management increases the chance that the contractor will not perform well in achieving the aims set in the contract and, that the contractor will violate contract terms. (Kelman 2009: 171.)

Even though it should be clear that the responsibility for the quality and content of the service cannot be transferred to the contractor, the public employees are occasionally misguided and avoid their responsibilities. (Huque 2005: 78.) Additional concerns were raised by Freeman & Minow (2009: 5) whether in-house employees are able to obtain adequate information about their service deliveries as a significant portion of them are contracted out. If the employees are not familiar with the service delivery process, efficient monitoring and measuring becomes extremely challenging.

5. CONCLUSIONS

Contracting out public services and the management of public service deliveries were discussed throughout this study. The specific research questions were how managing contracted out service deliveries differs from managing in-house service deliveries and how public service deliveries should be managed in order to achieve success.

The introducing chapter presented the background of the study, discussed the research question specifically, and presented the structure of the study as well as the main concepts. After the introduction public service management and the characteristics of public services were discussed in chapter two. Chapter three presented the phases of the contracting out process from the manager's point of view. Chapter four discussed public management with contracts. This fifth and final chapter concludes this study by presenting its central findings. First more general conclusions are discussed and then the research questions are answered more specifically. Finally future prospects and ideas for further study are briefly discussed.

5.1. Central findings

As the two public management doctrines were further discussed and compared in the course of this study, the similarities and especially the differences between managing contracted out service deliveries and managing in-house delivered services became increasingly obvious. The most significant difference is the main management instrument. As public contract managers depend on the contract, the public service manager values his/hers personnel as the most valuable asset.

Furthermore public management with contracts requires completely different resources from the managers than public service management as the procedures of organizing the public service delivery differ significantly. The process of contracting out, from organizing the competitive tendering to measuring the outcomes, requires management to detail in its every phase since even a minor mistake made during the process can lead

to significant difficulties within the public service delivery. Public service management is more about coordinating the public service delivery as wholeness.

As contracting out is first implemented in a public organization, managing the process of contracting out and the actual public management with contracts require more resources and effort than traditional public service management, since the organization is still in the process of learning the contracting out procedures. When public service deliveries are contracted out the public manager needs to obtain a new role and learn to function in an utterly different environment than before. Due to the difference in the management roles public service managers are not necessarily able to succeed as public contract managers.

The success of a public in-house service delivery depends greatly from the human resources. Careful formation of the service strategy that guides the whole personnel's functioning within the public service deliveries is equally important. Managing a public in-house service delivery requires abilities to motivate the employees and support their willingness to serve the citizens as the customers of the service delivery. This is the pitfall of public service management; it is not easy to find the right employees and keep them motivated. Public contract managers are not responsible for employee motivation, but correspondingly contract negotiations are the most critical aspect in public contract management.

The contract has to be skillfully negotiated and written. Even if the public contract manager has established a trusting relation with the contractor, the interest of the purchasing public organization needs to be protected in the contract. Furthermore a public contract manager has to deal with continuous stress. During the process of contracting out the threat of facing trial in market court is present at all times due to the comprehensive legal protection of the private organizations placing tenders. In addition the performance of the service delivery and the public service manager are constantly measured.

As discussed in the previous chapters of this study, the question whether or not to contract out public services is ambiguous. This study did not try to answer this trivial question, but bases for making the decision to contract out a public service delivery were presented. The assumed benefits of contracting out public services were also discussed; it seems that cost savings and increased efficiency can be achieved through contracting out public services, *if* the public contract manager is able to manage the whole process of contracting out from the make-or-buy decision to the end of the contract period skillfully. The importance of professional public management is highlighted in management with contracts, since mistakes are difficult if not impossible to repair during the contract term. Public service managers operate in a more forgiving environment as there are more opportunities for altering the budget or the content of the public service delivery if necessary.

The central findings of this study are further illustrated in table 3 on the next page, in which the differences and similarities between managing in-house delivered public services and public management with contracts are compared in different public management areas. These areas are based on the issues that were raised central in achieving success in public service and public contract management in the previous chapters of this study. Although managing contracted out public services is divided into managing the process of contracting out and managing with contracts in the previous parts of this study, in table 3 managing contracted out public services is not divided correspondingly in order to improve the understandability of the comparison's central findings.

Table 3. A Comparison between managing in-house delivered and contracted out public services

	Planning	Organizing	Budgeting
Managing in-house delivered services	<p>Forming and implementing the service strategy.</p> <p>The service delivery can be modified if needed.</p>	<p>Based on hierarchy.</p> <p>Organizing the service delivery requires specifying the need for the service and organizing the needed resources.</p>	<p>Flexibility is possible within certain limits.</p>
Managing contracted out service deliveries	<p>Forming and implementing the service strategy.</p> <p>Careful planning is essential, since modifying the contract is difficult.</p>	<p>Based on contract and partnership.</p> <p>Specifying the needed service, organizing a competitive tendering and writing and negotiating the contract. Dealing with the threat of facing trial.</p>	<p>All changes have to be negotiated with contractors; hence the budget is mostly fixed during contract periods.</p>
Major similarities and differences	<p>The process of strategy forming is similar whether the delivery is contracted out or not, but the content of the service strategy is different.</p> <p>In both cases the content of the delivered service should be as specified as possible, since careful planning and specification contributes to the predictability of the service delivery's costs and outcomes.</p>	<p>Organizing a contracted out service delivery is more toilsome, since the process is strictly regulated and the contract has to successfully negotiated.</p> <p>An in-house service delivery can be organized relatively effortlessly, since there are no rules or regulations considering the execution of the delivery.</p>	<p>Budgeting is more flexible as services are delivered in-house, since the public service manager is able to make changes when needed.</p> <p>If the delivery is contracted out the contract price is fixed in the contractor's tender. Often changes cannot be negotiated until the contract period ends.</p>

Directing	Coordinating	Communicating	Monitoring
<p>Direct orders to employees are possible. Promoting customer-orientation and motivating the public service employees.</p>	<p>Implementing service strategy, hierarchy and managerial decisions.</p>	<p>Communicating directly with the employees delivering the service to the customers.</p>	<p>Reporting is based on hierarchy. Continuous monitoring of in-house functions and specific assessments.</p>
<p>Orders go through contractor's management. The contractor manages and motivates the employees delivering the service.</p>	<p>Implementing service strategy, developing the partnership and communicating with the contractor.</p>	<p>Communicating through contractor's management and communicating with the contractor's management.</p>	<p>Reporting is based on the contract. Measuring and monitoring contractor performance. Feedback from the customers is important.</p>
<p>Public contract manager directs indirectly, since the contractor's management is responsible for day-to-day management. Main focus is on building a functional relation with the contractor.</p> <p>When services are delivered in-house the public service manager is responsible for the direction of every task related to the service delivery.</p>	<p>The whole idea of coordinating the public service delivery is different if the delivery is contracted out, objectives for the delivery may be similar but the means are not.</p>	<p>As services are contracted out trust or the lack of trust becomes central in terms communicating with the contractor.</p> <p>In public service management the functionality of the communication depends on the relationship the manager has with the employees.</p>	<p>The monitoring of an in-house service delivery is often based on counting the cash profits. The level of achieving the organizational goals is also measured.</p> <p>The importance of monitoring is highlighted as the service is contracted out. It is crucial to monitor regularly that the contractor is following the contract terms and delivering quality services.</p>

5.1.1. Major similarities and differences

As table 3 illustrated the two public management doctrines are similar in some areas, but the differences between them in most areas of management are more significant. The most notable differences between public contract management and public service management are the process of organizing the service delivery and the contract. The contract as a management tool makes the sole nature of managing contracted out public services different from managing in-house delivered services. A public service manager can be successful without understanding contracts as a public contract manager will fail dramatically if he/she is not able to manage the delivery as wholeness with a contract.

In terms of planning and determining the form of a public service delivery, forming the service strategy is the most important aspect in a public organization. The strategy formation process is similar in public service and public contract management. Public organizations' objectives must be combined with the political guidelines and the limitations of the organization's budget. The public organization's service strategy forms the basis for making the make-or-buy decision. The make-or-buy decision has traditionally been a political or an ideological decision. But as Finland is struggling to stabilize its public sector's finances in the aftermath of the recession in 2008-2009, the make-or-buy decisions are more often based on estimations of which delivery form, in-house or contacting out, will create more cost savings.

As table 3 illustrated, the process of organizing the public service delivery is completely different if the public service delivery is contracted out. Organizing a public in-house service delivery is rather simple but if the public service is contracted out a strictly regulated competitive tendering is to be organized. Managing the process of contracting out is critical and law suits are a potential threat. The fear of facing trial after the competitive tendering is a shadow over the public contract manager, since a trial in market court inflicts additional costs on the process and delays the writing and negotiating of the contract. If mistakes are made when writing and negotiating the contract, they influence the public contract manager's work throughout the contract

period. The importance of carefully following the law and negotiating beneficial contract terms cannot be highlighted enough.

Furthermore the process of forming a budget for the public service delivery is a difference between the two management doctrines, although the premises for budgeting are equal since every public organization has limited funds. The limited budget is the main reason for constantly aspiring cost savings and trying to do more for less. If the public service is delivered in-house the budget can be modified when needed, as in comparison the budget for a contracted out public service delivery is set in the contractor's tender. The budget for a contracted out public service delivery cannot be changed until the contract period ends. This is one of the main reasons contributing to the fact that the price of the service is often stressed as a criterion in an ITT.

Public contract management and public service management differ significantly in terms of directing. A public contract manager is directing the contractor and a public service manager is directing the public employees delivering the service. This difference contributes to the different roles that the public managers need to obtain. The public service manager needs to be a coach and a motivator as the public contract manager is required to act as a leader and a partner. If the public contract manager's relation with the contractor is functional and the communication between the contract parties is honest, the public contract manager's work becomes significantly easier. On the other hand the public service manager's biggest asset are the employees delivering the public service and interacting with the customers, the core of successful public service management is skilful human resource management. In comparison as a public service delivery is contracted out the contractor's management is in charge of motivating and directing the employees delivering the service to the customers.

Furthermore the whole idea of coordinating the public service delivery is different if the delivery is contracted out, as explained in the context of organizing the service delivery. Although the bases and means for coordinating a contracted out public service delivery are written in the contract, coordinating the public service delivery is additionally depended on the relation between the public contract manager and the contractor's

management. The public contract manager needs to coordinate the delivery through the contractor's management. The key to successful coordinating in public management with contracts is open communication and cooperation with the contractor. Correspondingly coordinating a public in-house service delivery is based on hierarchy, as was illustrated in table 3.

A successful public service manager pursues honest communication with the employees and uses communicating as a mean for motivating them. Functional communication is important in public service management, but regardless of problems with communicating the public service delivery often remains functional. As for public contract manager functional and regular communication with the contractor is essential. If there are issues with communication for instance the contractor does not share information openly the public service delivery becomes dysfunctional.

Monitoring the quality and efficiency of a public service delivery is important for both public service and public contract managers. The feedback coming from the customers and the information gained from the measurement systems are the bases for developing and improving the public service deliveries. Measuring the performance, quality and cost efficiency of a public service delivery, whether delivered in-house or contracted out, is essential in terms of successful management of public service deliveries. The rhythm of competitive tendering makes a difference in measuring the quality and outcomes as frequent competitive tendering means frequent measurement of the public service delivery outcomes.

These public management areas illustrated the similarities and highlighted the differences between public service management and public contract management. Even though both public managers are managing public service deliveries, the day-to-day tasks and means for achieving success in management are significantly different. Different areas are crucial for public service and contract managers as managerial success is pursued in public organizations. Keeping this in mind some general observations about how public service deliveries are successfully managed are presented in the following chapter.

5.1.2. How should public service deliveries be managed?

In addition to discussing the similarities and differences of the two public management doctrines that were compared in this study, more general conclusions about how success in managing public service deliveries is achieved are presented in this chapter.

Forming the service strategy and carefully specifying the content of public service deliveries is essential in terms of successful public management. A service strategy contributes to the manageability of a public service organization significantly. A public organization with clear objectives is easier to manage, managerial decisions are easier to make implementing the strategy and measuring the success of achieving the set objectives gives valuable information to public managers and instruments for developing the public service deliveries. Concentrating on managing the human resources and improving communication within the public organization are additionally crucial aspects in successful management of public service deliveries.

On the other hand there are problems that often emerge on public service deliveries that add challenge to managing the delivery. For instance variations in the need for the public service, poor experienced service quality and issues in communicating with service deliverers, whether the contractor's employees or public employees, inflict problems. A successful public manager is able to find creative solutions to emerging problems by communicating and implementing the service strategy.

Public managers have multiple responsibilities and they are held accountable to the public, media and political leaders. As managing public service deliveries the public managers must ensure that traditional public values are always realized, even if the service is delivered by a private contractor which often makes the process of ensuring more difficult. Serving the citizens' needs and actualizing accountability, transparency and equality of public service deliveries are the objectives that every service manager in a public organization must internalize and promote. The implicit requirement of delivering public services equally to each citizen is the most significant element contributing to the uniqueness of public service deliveries.

Furthermore understanding the complexity and characteristics of public services and the citizens as the clientele are essential for all public managers, since the special characteristics of public services contribute to the challenges and complexity of managing public service deliveries. The diverse group of citizens as both funders and customers of public services have very different needs and expectations for the deliveries and they also are often critical of the public service delivery content. The diversity of citizens as customers make satisfying every customers' needs impossible as managing public service deliveries. This is the most significant issue in managing public service deliveries.

In addition to aspiring to satisfy the citizens' varying needs and demands, the public manager in charge of the service delivery is expected to keep the delivery form and content in line with political decision-making and be as cost efficient as possible. A public manager must understand the complexity of the public service delivery as wholeness and the contradiction in the demand for highest possible service quality at the lowest possible price. Public service managers, whether the public service deliveries are contracted out or not, are constantly challenged in their work as they are balancing in the center of all these requirements. The challenges in managing a public service delivery make public service management and public management with contracts on one hand very challenging and on the other hand extremely rewarding as success is not easy to achieve.

The most important aspects in managing public service deliveries successfully are the specification of the public service delivery content and objectives, human resources management, communication and monitoring the public service quality and cost efficiency. Public service managers and public contract managers must be able to form partnerships and rely on their employees or partners (contractors). Achieving success in delivering public services requires above all cooperation which is organized and directed by the public managers.

5.2. Future prospects and further study

As discussed in the previous chapters of this study, contracting out public service deliveries often has beneficial outcomes, but success in managing with contracts is by no means guaranteed. Correspondingly public service management and delivering services in-house has its advantages and disadvantages. Therefore this study does not highlight either one of the compared management doctrines as better or more functional. However it can be stated that public contract management should be further researched and means for successful public management with contracts should be developed, since contracting out public service deliveries is increasingly implemented in public organizations in hopes of achieving efficiency and cost savings. Hence a research about how public managers can contribute to delivering better quality services to citizens would be a beneficial topic for further research within the field of public management.

As this particular study is theoretical, questions such as how public contract managers are performing in practice and what are the main issues in day-to-day public contract management remain to be discussed in further empirical studies. In this study public contract management was compared with public service management in order to improve the understandability of managing with contracts in public organizations. Further study could concentrate solely on the management of contracted out public services as contracting out is becoming increasingly popular within the public sector. As this study was written widespread contracting out of public service deliveries is a relatively new phenomenon, presumably within few years there will be more material for more detailed research.

As Finland's new government published the government program in June 2011 for the upcoming four years, it became clear that contracting out public services is going to be implemented even more extensively than before. (see Valtioneuvosto 2011.) The Finnish government needs to desperately realize cost savings and increase the efficiency of public service deliveries. The best available mean for using public funds more efficiently is contracting out public services. It remains to be seen how this development will affect public management with contracts in terms of management research and formation of best practices.

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