

Public Managers “Managing The Market”: Surveying the Effects of Strategic Interventions in Public Service Markets

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The expansion of government contracting is well documented, as is the challenge posed for governments as they attempt to ensure high quality service delivery, accountability to citizens, and maximum public value. Early developments in the proliferation of contracting occurred against a backdrop of increased interest in market principles and strategies for public service delivery, and a belief in the capacity of market competition to improve service quality while reducing costs.

More recently, the theoretical foundation that justifies government contracting, grounded in the economics of competition and production cost, is under question. Those who are skeptical about the public choice and market failure rationales for outsourcing have assessed contracting through the frameworks of public values (Bozeman 2007; Jorgensen and Bozeman 2007), constitutional and administrative law norms (Rosenbloom and Piotrowski 2005; Moe 1987; Gilmour and Jensen 1998; Hansen 2003), and social equity (Radin 2006; Hefetz and Warner 2004; Frederickson 1996). Other scholarship on contract management – focused on design, implementation, and oversight – reveals that very often, outsourcing simply does not conform to the market theory driving its use (Johnston and Romzek 1999; Romzek and Johnston 2005, Kettl 1993). That logic rests squarely on the potential of competition and external expertise to decrease costs and enhance the efficiency of government programs and services (Bretschneider and Ni 2007; Hefetz and Warner 2004; Savas 2000; Boyne 1998; Pack 1987).

We will address these issues as we examine the work of contract managers and their efforts to manage features of the markets from which they acquire goods and services on behalf of citizens. “Thin” provider markets (Weimer and Vining 2005) are an endemic problem, especially for certain service types and levels of government. A second challenge relates to the heightened awareness that even when available vendors are plentiful, competition often fails to deliver its purported benefits. In many markets that were originally competitive, managers face conditions of low competition due to provider consolidations and mergers. The stark reality is that the expertise they seek from nongovernmental organizations sometimes delivers less value than anticipated, particularly in view of the special demands of government and the public interest.

With these issues as a framework, this article wrestles with empirical questions that have received relatively little attention in the contracting literature. First, drawing on results from recent primary survey data, supplemented by semi-structured interviews with federal, state, and local contract administrators, we examine the impact of “market management” and other transaction costs on contract effectiveness, with a focus on performance and accountability to the public interest. While many market management strategies have been cited in contracting research, primarily in the context of the transaction costs associated with economic exchange (Coase 1937; Williamson 1981), the concept remains largely unstudied (for exceptions, see Warner and Bel 2008; Warner and Hefetz 2008; Graddy and Chen 2006; Brown and Potoski 2004; Fossett et al. 2000).

Our data provide insights from managers on the front lines of outsourcing. Local government officials – specifically, city managers and department heads in a variety of service areas – have provided responses to a wide range of survey questions related to contracting, contract management, and contracting outcomes.¹ These responses support the notion that contract managers expend significant resources on managing the market, and that the related and often unrecognized opportunity costs can include diminished attention to other elements of contract management, and therefore to the performance and accountability expected when public resources are used to acquire goods and services from nongovernmental actors.

Market Theory and Contracting

The dynamics associated with competition are intrinsic to the rationale for government to contract with nongovernmental organizations. Competition, and the efficiency it fosters, results when an organization “must compete for market share, functions and resources” (Cohen 2001, 434). Donahue (1989) emphasizes the “cardinal importance of competition” in privatization, stating that “most of the kick in privatization comes from the greater scope for rivalry when functions are contracted out, not from private provision *per se*....Efforts to compensate by other means for the missing discipline of competition will seldom be fully successful” (218). According to this view, competition forces producers to control costs and deliver quality services because there are consequences for inefficient behavior (i.e. purchasers

choose another supplier) (Greene 2002; Kettl 2002; Pack 1987). Thus, “the primary goal of any privatization effort is, or should be, to introduce competition and market forces in the delivery of public services” (Savas 2000, 122). The underlying objectives include maximizing return on taxpayer investment while improving government performance, customer service, and citizen well-being (Kelman 2002; Osborne and Gaebler 1993).

Many of the challenges associated with the current wave of government contracting have to do with expansion in the scale and scope of contracting – an expansion that has occurred despite evidence that competition for government contracts is often insufficient. One report finds that the number of federal contracts awarded under full and open competition declined from 2000 to 2006, from 45% of the total to 34% (openthegovernment.org 2007 in Yost). This trend is especially troubling because over 25% of discretionary federal spending now goes to contracts (GAO 2006). Thus, a substantial portion of federal contracting does not follow the market logic of contracting.

States also experience thin markets as they increase their reliance on contracts for service delivery. The trend toward state contracts for social welfare services accelerated with passage of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Nathan and Gais 1998), and research indicates that for many, if not most of these services, competition is often insufficient (Johnston and Romzek 1999; Romzek and Johnston 2002; Van Slyke 2003; 2007; DeHoog 1990; Smith and Smythe 1996; Schlesinger et al. 1986). In the case of Medicaid managed care, which comprises the second largest portion of state general fund budgets (after K-12 education), many state HMO contracts attract two or fewer bids (Fossett et al. 2000).

Evidence suggests that local governments also face thin markets for some of their services (Johnston et al. 2004; Hirsch 1995; Kodrzycki 1994; Hefetz and Warner 2004; Warner and Bel 2008; Warner and Hefetz 2008; Amirkhanyan 2007).² Despite the more “private” nature of goods and services provided at the local level, the provider supply market is less vigorous than theory might predict. More importantly, the existence of, or promise of competition is not guaranteed by any specific number of vendors, and there is no clear consensus on an optimal number of bidders. Three or more bidders seem to

be widely accepted as indicative of some minimal level of competition. Assumptions underlying the concept of a fully functioning market typically include a requirement for “many” buyers and sellers, or producers and consumers, with ease of entry to and exit from the market. By contrast, The Reason Foundation suggests that competition exists when at least two providers compete in a bidding process. Former Indianapolis Mayor Stephen Goldsmith concluded that adequate competition was established when three or more vendors bid, and in that count he often included city departments authorized to compete for city contracts.

The managers in our survey do not demonstrate consensus on this matter, either, as demonstrated in Table 2. At 62%, well over half view the “optimal” number of vendors as five or higher. And they are sometimes also constrained by legal or political forces that limit vendor competition, such as requirements that purchasers give precedence to specific portion of the supplier markets. While these goals may seek to meet non-economic policy objectives – in many cases to provide a competitive edge to businesses that are underrepresented, like women, minorities, and other favored groups – they do result in artificial market constraints. Likewise, it is not unusual for executive or legislative actors to require or otherwise encourage government purchasers to favor local, regional, or state vendors in order to internalize any resulting economic benefits from contracting. Forty-three percent of our respondents report that their agency policies include preferences for traditionally disadvantaged vendors. A comparable portion indicates similar policies favoring local/regional vendors. These scenarios can create further complications for competitive sourcing when searching for qualified, available vendors in the marketplace.

Questioning the Benefits of Competition

Many contracting scholars emphasize that even when vendor competition is adequate, competition does not deliver the benefits promised by theory (Warner and Bel 2008; Brudney et al. 2004; Sclar 2000; Boyne 1998; Hirsch 1995; Donahue 1989). And the efficiency promised by contracting theory competes with constitutional and political values such as responsiveness, responsibility, accountability, due process, transparency, effectiveness, equity, and other public values (Bozeman 2007;

Rosenbloom and Piotrowski 2005; Cooper 2003; Milward and Provan 2000; Frederickson 1996; Moe 1987). Recent emphasis on “best value” contracts reflects, in part, renewed attention to these alternate values. Best value contracts consider lowest cost as one of several criteria to be evaluated, thus balancing competing values of importance to the specific program or service. In this approach, performance, and accountability to public values, become as important – or perhaps more important – than simple cost reductions.

Paradoxically, the administrative coherence associated with a more stable, monopolistic system is often sacrificed when competitive contracting is used. The instability inherent in contracting (Johnston and Romzek 2008) may help explain why we see evidence that more monopolistic, less competitive markets may be preferable from a performance point of view, at least for certain components of a service delivery network (Warner and Bel 2008; Romzek and Johnston 2002; 2005; Milward and Provan 1998; 2000). While some “optimal” level of competition may exist, it appears that increasing levels of competition for some government contracts may be associated with diminishing returns. Put simply, competition does not guarantee improved or more cost-effective government or policy (John and Ward 2005), nor does outsourcing in general (Boyne 1998; Warner and Bel 2008; Bel and Warner 2007). In addition, competition can induce seepage of expertise from government to contract organizations willing to outbid government for knowledge workers with program experience and institutional history (Romzek and Johnston 1999).

Despite the shortcomings of competition, it is clear that an absence of competition is also undesirable and has the potential to diminish performance in government contracting. Public managers, acutely aware of this, often focus their energies on creating healthy levels of provider competition when they design and implement contracts. These efforts represent an unrecognized element of contracting transaction costs.

Market Management as Transaction Cost

Our data demonstrate that public managers engage in a variety of behaviors and adopt numerous strategies to ameliorate the shortcomings of a thin provider market, to maintain competition after

contracts take effect, to ensure adequate competition for future purchases, and to otherwise strengthen vendor markets. We find that public managers frequently seek additional vendors through advertising the contract (beyond public posting requirements), and by searching the yellow pages and Internet. They also routinely rely on their counterparts in other local governments and professional vendor associations to steer them to available vendors.

The notion of “managing the market” may appear paradoxical, given the “free market” ideal; nonetheless, public managers do indeed create, shape, nurture, and expand provider markets (Warner and Hefetz 2008; Allen and Walker 2007; Graddy and Chen 2006; Fossett et al. 2000). Yet there is little detailed research on these practices or their implications. Our analysis supports the notion that public managers have a keen understanding of the importance of competition, its impact on costs and other performance objectives, and that they respond strategically by intervening when markets are weak.

The reality is that when contracting decisions are made, projections of cost reductions through contracted production and service delivery often fail to account for transaction costs – the resources required to develop, maintain, and monitor contracts (Sclar 2000). Some estimates suggest that these transaction costs may supplement direct contract costs by up to 25 percent (Prager 1994; DeHoog 1990; Pack 1989). Many contract managers indicated to us that administrative costs are nearly always ignored when the contracting decision is made. These managers, steeped in the reality of contract administration costs, and frequently operating in strained resource environments, find their capacity to provide adequate oversight further challenged when they must also “manage the market.” And there is little doubt that “managing the market” raises transaction costs beyond the more familiar contract development and monitoring activities (Warner and Bel 2008).

Public managers contend with markets that range from conditions of low vendor supply, to provider markets constrained by legal and political forces, to provider consolidation (and, in some cases, vendor monopoly). Competition is not static. Considerable attention must be paid to markets after a contract takes effect because government contracting may in fact encourage provider consolidation and thereby reduce competition (Sclar 2000). In the post-contract phase, contract managers also expend

resources to retain, nurture, and strengthen organizations that threaten to leave the market (often because bidders did not fully understand the costs related to the contract), or are otherwise vulnerable to failure. These dynamics are supported in both our interview and survey data (Johnston and Girth 2008). As Table 1 indicates, 20% of our respondents mentor contractors to ensure their continued participation in the market.

Market management costs add to the transaction costs traditionally associated with contracting. At the same time, opportunity costs are created because administrative resources are diverted from the monitoring of performance and accountability. The transaction and opportunity costs related to managing the market further reduce the justification for outsourcing because they lower the net benefit of the contract to the government purchaser. In the following sections, we report results from data that detail some of these costs and their impacts on contract effectiveness – specifically, on performance and accountability to public values.

Managing Markets by “Chasing” and Maintaining Competition

Government contracting officials use a wide array of approaches designed to stimulate provider competition. Indeed, some contract specialists have noted in our interviews that they devote more time to “chasing” competition than to other components of contract management. Remarks about “building an industry” – e.g., creating a supplier market – and “growing the competition” are representative of these dynamics. State Medicaid managed care administrators dedicate scarce staff resources to ongoing efforts to “keep [HMO] providers in the game” (Fossett et al. 2000; Johnston and Romzek 1999).

Interview respondents also indicate that the healthiest levels of competition are not among the primary organizations with which the government contracts, but instead among the multiple vendors with sub-contracts. This subcontractor market, in most instances, cannot be directly monitored, raising critical accountability and responsiveness issues, not to mention cost questions. Despite the competition they bring to the service delivery system, these subcontracts – and their distance from proximate state oversight – impose opportunity costs associated with diversion of resources from direct program

monitoring and performance improvement. Indeed, 67% of our survey responses indicate that subcontractors make their oversight more complicated.

In some cases, public managers must devote energy to the retention of existing contractors that, for a variety of reasons, may wish to withdraw from their current contracts. DeHoog (1990), Van Slyke (2007), and others discuss this under the rubric of “relationship contracting” and “stewardship.” The nurturing and mentoring of contractors is costly. This more familiar set of contract transaction costs is more widespread as contracting has expanded into new service areas. Our survey responses support this notion. As can be seen in Table 1, over one-fifth of the respondents spend significant portions of their time helping contractors improve their current performance.

Government administrators may also create competition in thin markets by requiring public organizations to bid on public contracts. Warner and Hefetz (2008) find that “mixed delivery” - this combination of public and private service provision - has become a common alternative to competitive bidding in local governments because “experienced managers were more likely to use mixed delivery rather than trust the market to ensure cost efficiency and failsafe service” (10).³ According to our survey, 87% of local government managers use mixed delivery, and 32% report that they have created new vendors through existing organizations (by encouraging them to create subsidiaries) to increase supply.

And over time, provider consolidation creates additional management challenges. Sclar (2000) warns policy makers that “Even when a market initially appears to be competitive, policy makers must remain wary. Public-contract markets, like most markets, change quickly and continually. Often, the very act of creating a public-contracting process sets anticompetitive forces in motion. What begins as apparent competition quickly transforms itself by the second or third round of contracting into monopoly or, more typically, oligopoly” (70). Among federal contractors, the vendor consolidation rate has doubled in the last seven years, and mid-size companies hold 33 percent of federal contracts in 1995, down from 44 percent in 1995 (Goldfarb 2007). Federal contract managers face the reality that while “for many years, the middle tier of companies in the \$200 billion federal services industry was regarded as a source of innovation and productivity,” consolidation creates an environment in which companies are

likely to become less innovative, more standardized, more bureaucratized, more powerful in the procurement relationship, and more dominant in the market (Goldfarb 2007, D01; see also Schlesinger et al. 1986). There is also evidence that over time, performance incentives need to be regularly re-calibrated (Marvel and Marvel 2007); as a result, more staff resources are required for fine-tuning incentives, and less remains for conventional contract oversight.

Interviews with contract managers reveal that for some, consolidation is a constant concern. For instance, administrators of state child welfare contract organizations reported that “vertical integration” was increasingly attractive as cost pressures made sub-contracting less profitable. Small, precariously financed contract and subcontract organizations fully recognize their vulnerability under these conditions (Romzek and Johnston 2005) as they compete increasingly with large, dominant contractors. As Graddy and Chen (2006) observe, “most lead agencies have been successful in renewing their contracts” for local family preservation programs in Los Angeles, “some for several cycles. Thus, just as we find in franchise arrangements, this structure could create long-term contracts that begin to look like monopolies” (548-9). Schlesinger et al. (1986) described the multiple forces encouraging consolidation among contractors for mental health services in Massachusetts. These forces included economies of scale in both provision and bidding.

These consolidation dynamics push contract managers to devote more resources to stimulating provider markets. Yet as they strive to expand and enhance competition, managers are swimming upstream against forces that lead some contractors to leave the market, others to consolidate, and still others to fail in the face of competition from large, entrenched organizations. And while contracts are active, managers continually scan for new vendors for the next cycle, in part to address consolidation issues, and in part to create some purchasing advantage over existing contractors who correctly assume that they can use incumbency to enhance their competitive position.

Fifty-three percent of our survey respondents report that they seek additional vendors during active contracts for the next outsourcing cycle. Fifteen percent indicate that bidders buy each other out post-contract, and 21% report that bidder supply for specific services decrease over time (see Table 1).

Managing the Market, Resource Diversion, and Opportunity Costs

Contract administrators intervene to manage the market when low levels of competition put the government purchaser at a disadvantage. And like all public managers, they manage performance – in this case, the performance of third-party contractors. Yet ironically, market management creates opportunity costs by diverting contract oversight resources in those very situations that require more intense contract monitoring and performance management. Thin markets therefore deliver a double contract management whammy. They require more intense contract management, yet they also drive contracting officials to manage the market in order to increase competition, thereby reducing resources available for those intense contract oversight needs. Many contract administrators emphasized in our interviews that under such conditions, they are hard pressed to deliver the best return to citizens, in terms of service quality and cost.

Contract managers' detailed insights into competition enhancement strategies expose the contours of "market management" strategies and activities designed to create, sustain, and stimulate provider competition. Their responses detail the impacts on staff time and energy, and help put a face on the transaction costs associated with contracting under conditions of sub-optimal competition. The bottom line is that when markets are noncompetitive, these problems proliferate, increasingly scarce administrative resources are stretched even thinner, and diversion from oversight functions can lead to highly problematic results.

Our survey data provide further evidence of these dynamics by reporting the views of public managers responsible for government contracts. In the section below, we report early results of relationships between market management activities – transaction costs that are often obscured – and contract effectiveness. We focus specifically on managers' perceptions of effectiveness in terms of contract performance and accountability to the public interest.

Data and Methods

As previously noted, the research presented here combines interview and survey data collected by the authors. In this section, we report results from a survey of local government contracting officials.

Based on a sample drawn from The National League of Cities' Association Management System, as described earlier, the dataset currently includes 185 observations, representing a preliminary slice of responses. Data collection is still underway and the results presented in this paper are preliminary.

To examine contract performance, quality improvement and accountability, we utilize three multivariate models of contract effectiveness. These dependent variables give us three separate, and quite distinct, measures of performance and accountability:

- *Service cost reduction* - A measure of contract performance based on respondent perceptions of cost savings from agency contracts; the variable is ordinal, coded 1-5 based on a Likert-type scale
- *Service quality improvement* - A measure of contract performance based on respondent perceptions that agency contracts provide higher service quality than could be delivered in-house; the variable is ordinal, coded 1-5 based on a Likert-type scale
- *Public value enhancement* - A measure of accountability based on respondent perceptions that citizens are made better off by their agency contracts (in other words, they perceive that the contract results enhance accountability to citizen preferences and the public interest); the variable is ordinal, coded 1-5 based on a Likert-type scale

The independent variables of interest include measures of market management and related transaction costs.

- *Market management (MM) of vendors* - Factor score developed from responses to questions using a five-point Likert-type scale to measure managers' perceptions on the following dimensions: satisfaction with vendor supply levels, resignation to working with few vendors because MM efforts have failed, lack of success in efforts to find more vendors, difficulty finding high quality vendors⁴ (-)
- *Market management (MM) of bidders* - Factor score developed from responses to questions using a five-point Likert-type scale to measure managers' perceptions on the following dimensions: satisfaction with the number of available bidders, resignation to working with few bidders because MM efforts have failed, market consolidation as represented by decreasing levels of bidder competition for contracts over time, and prevalence of bidder buyouts of their competitors (-)
- *Market management (MM) opportunity costs*: Factor score developed from responses to questions using a five-point Likert-type scale to measure managers' perceptions on the following dimensions: extent to which more time is spent seeking vendors than expected, diversion of resources from contract oversight due to the need to find more vendors, and spending more time finding vendors than on contract oversight (-)
- *Legal constraints on the market* - Indexed variable reflects political decisions to legally

constrain vendor selection, and includes managers' perceptions of the extent to which their agencies extend preferences to traditionally disadvantaged vendors and to local vendors (-)

We also include several control variables:

- *Political influence* - Indexed variable measures pressure from political actors to outsource, to restrain sanctions for poor vendor performance, and to give performance leeway to contractors with political connections (-)
- *Agency culture* - Ordinal variable measures manager' perceptions of their agencies' support for sanctioning poor vendor performance (+)
- *Contract management capacity* is measured with two variables:
 - *Expertise* – Ordinal variable measures managers' perceptions of agency expertise in contract management (+)
 - *Education* – Ordinal variable measures respondents' level of education (+)
- *Years in public service* – Continuous variable measures respondents' tenure in government (+)
- *Perspective on nongovernmental sector* – Ordinal variable measures managers' perceptions that contractors are more interested in the bottom line than in other goals (-)
- *Trust* - Ordinal variable measures managers' perceptions that contractors generally act in good faith (+)
- *Service type* - General description of service area overseen by respondent, as reported to National League of Cities:⁵
 - *Building inspector (BI)* – Binary variable, coded 1 if respondent works in BI agency, otherwise 0
 - *City manager (CM)* – Binary variable, coded 1 if respondent works in CM office, otherwise 0
 - *Health and human services (HHS)* – Binary variable, coded 1 if respondent works in HHS agency, otherwise 0
 - *Information technology (IT)* – Binary variable, coded 1 if respondent works in IT agency, otherwise 0
 - *Parks and recreation (PR)* – Binary variable, coded 1 if respondent works in PR agency, otherwise 0
 - *Public works (PW)* – Binary variable, coded 1 if respondent works in PW agency, otherwise 0

Survey Results

Table 2 provides distributions of responses to selected survey questions. In addition to the multivariate analysis results described below, we found interesting patterns of response from public managers in a number of dimensions. First, a closer look at distributions provides evidence that public

managers typically embrace contracting in the generic sense as 97% of the respondents “generally support the concept of government contracting.” But at the same time, they appear to also express preference for in-house provision, constraining their perceived enthusiasm for contracting, as 66% would select in-house provision over contracting if given the choice.

Respondents were asked to consider benefits and drawbacks of contracting in their agency. Accountability is clearly a key concern for local government officials dealing with contracts as 45% of respondents indicate “difficulty of holding contractors accountable for their performance” as the greatest single drawback of contracting. This also holds true for respondents across all service areas –public works, information technology, inspection services, parks and recreation, human services, and city managers agree that accountability is the dominant drawback of contracting. When public managers evaluate the greatest benefit of contracting, the consensus is not as clear – 35% of public managers cite cost savings, 31% cite increased flexibility in service delivery, 16% cite increased staffing flexibility, while only 12% cite higher quality goods/services.

Table 3 reports the results for the first performance model – *Service Cost Reductions*. The OLS coefficients for vendor market management (MM for vendors) are significant and in the expected direction.⁶ This suggests that when it comes to contract performance, as measured by service cost reductions, the need to manage markets detracts from perceived contract effectiveness. The same can be said of bidder market management (MM of bidders), but the result is not statistically significant. The opportunity costs associated with managing markets (MM opportunity costs), which divert resources from contract oversight, exhibit a significant relationship to perceived cost saving performance, though the direction is not in the anticipated direction. Instead of reducing performance, opportunity costs appear to exert a positive influence on perceived contract cost performance. One potential explanation for this unexpected result is that managers compensate for the diversion costs by scrutinizing these contracts more intensively, despite the administration and time burdens. If this result is supported in subsequent research, it suggests that at least in the area of cost performance, public managers are achieving contract cost performance despite formidable transaction costs.

The legal market constraints and political influence variables reduced cost performance in this model, but not at levels that reach statistical significance. In terms of agency culture, those agencies that support sanctioning contractors for poor performance appear to produce superior and statistically significant cost savings, as measured by managers' perceptions. Agency contract management expertise and managers' level of education and years in public service all appear to improve cost performance, though only expertise meets statistical significance. And when managers report agreement that contractors' interests flow more to the bottom line than to other goals (perspectives on nongovernmental sector) – they are also less likely to perceive agency cost reductions from contracting.

Finally, managers of specific service areas that contract out for the service types listed in Table 3, with the exception of human services and parks and recreation agencies, are less likely to agree that their agency contracts reduce costs, compared to city managers. This comports with our expectations that managers closest to the administration of contracts (e.g. Directors of Public Works administering contract for snow removal) have greater insights into the true costs of the contracting, compared to city managers who generally operate at an executive level, removed from day-to-day operations of contracts.

The impacts of market management and transaction costs are weaker for contract quality performance and for overall contract accountability to citizens and the public interest. The model in Table 4, which explains the second performance measure - *Service Quality Improvement* – reveals fewer significant coefficients. Nonetheless, the vendor market management variable is negative and significant, as expected. The coefficient for the bidder market management variable is both insignificant and positive, contrary to expectations. Here, legal market constraints appear to improve perceptions of service quality, perhaps because – although they may cost more, as suggested in the first model – reliance on more familiar local vendors permits sounder managerial assessments of vendor capacity and the potential for quality contract performance. A trust variable is negatively associated with perceived contract quality, contrary to expectations. Both political influence and market management opportunity costs exert negative impacts on perceived service quality but not at acceptable significance levels. While agency culture (support for sanctions) and managers' education levels are associated with perceptions of

higher quality outcomes, these relationships do not achieve statistical significance. Oddly, agency expertise exhibits a negative (but insignificant) influence on perceived performance. As noted in the cost reduction model above, managers of building inspection services and parks and recreation agencies that contract out for the service types listed in Table 4 are less likely to agree that their agency contracts reduce costs, compared to city managers.

Table 5 provides results for the accountability model – *Public Value Enhancement*. OLS estimates for both the vendor and bidder market management variables are negative, as expected; suggesting that market management is associated with reduced accountability, but only the vendor coefficient is significant. And, as in the cost model, the market management opportunity cost variable is positive (though insignificant). Again, we suggest that the opportunity costs associated with managing vendor and bidder markets may in fact spur added oversight and accountability. Because administrative time is a scarce resource, we can speculate that in addition to contract oversight, other mission elements – elements we have not yet accounted for in our data - may be shortchanged by these market management opportunity costs.

Legal market constraints are associated with higher public value enhancement, though not significantly. This result could reflect the fact that accountability to citizens is enhanced by incorporation of more local vendors and disadvantaged providers. The public values that underlie these market constraints appear to emerge here as reflected by managers' perceptions of how well the public interest is served by their agency contracts.

While the agency culture coefficient exhibits the expected sign, the political influence estimate does not; neither is statistically significant. Concern about the bottom-line orientation of contractors (perspectives on nongovernmental sector), is negatively, but insignificantly, associated with public value enhancement.

It does appear, though, that contract management capacity is an important determinant of public value enhancement and accountability. Agency contract management expertise and managers' education levels both exert positive and significant impacts on perceived accountability to the public interest. Years

in public service generates a coefficient sign that is contrary to expectation. Finally, with the exception of human service agencies, managers across service types listed in Table 5 are less likely to agree that citizens are made better off by their agency's contracts, compared to city managers.

To summarize, these results provide evidence that when public managers are faced with low levels of competition and supply in vendor and bidder markets, they intervene by devoting scarce administrative resources to fortifying and strengthening those markets. These "market management" activities are associated with perceptions of reduced contract performance and accountability. The market management variables in these models support the patterns observed in the qualitative component of this research.

On the other hand, our measures of opportunity cost generated estimates suggesting positive impacts on two of the three dependent variables - contract cost saving performance and overall contract accountability to the public interest. We cannot yet draw firm conclusions about the interplay between contracting outcomes and the opportunity costs associated with managing the market. But these results suggest that despite the diversion of administrative resources to market management from contract oversight, managers are somehow able to compensate and provide enhanced performance and accountability. Managers who fit this pattern tend also to report relatively high agency administrative capacity, and may therefore possess contract management skills that are comparatively effective and less time-intensive. The critical role of management capacity is reinforced by these results. Also important is an accountability culture, characteristic of agencies that support sanctions for poor contract performance.

Conclusion

Advocates of privatization and contracting stress that competition is the chief driver of improved efficiency and performance in government production and service delivery, yet this analysis indicates that provider competition can be both costly and difficult to achieve and sustain. We find that substantial portions of administrative resources are devoted to "managing the market" by creating, stimulating, and maintaining competition. As a result, scarce administrative resources may be stretched, pitting market

management objectives against contract performance and accountability.

In essence, our research demonstrates that managing the market entails real costs. Market management is an important – but often overlooked – element of the transaction costs associated with the outsourcing of public goods and services. Because contract management costs – including market management costs – often are not factored into contracting decisions, the administrative resources needed for effective contracting can be insufficient, and the cost effectiveness of outsourcing becomes highly questionable. At the same time, accountability could be compromised because market management creates opportunity costs manifested in reduced attention to service quality and other essential oversight activities.

Effective contract oversight and accountability are difficult to achieve under the best of conditions. But as the scope of government contracting expands beyond traditional bounds, contract managers are more and more likely to confront weak provider markets. Our survey results, while only preliminary, suggest that under such conditions, contract managers intervene to manage the market. These interventions can reduce performance and accountability. The impacts of market management transaction costs are less clear. They clearly exist – our respondents do report diversion from contract management as a result of market management activities – but in these preliminary models, opportunity costs do not significantly suppress contract performance and accountability. We speculate that additional analysis may reveal how and why some managers are more successful at mitigating these opportunity costs. The critical role of management capacity is reinforced by these results. Also important is an accountability culture, characteristic of agencies that support sanctions for poor contract performance.

While this paper does not offer definitive answers to those questions, it does attempt to shed light on the increasingly common and costly practice of “managing the market,” and on the implications for management, performance, and accountability to the public interest. Whether managing the market should fall under the purview of public managers is a legitimate question. But regardless of whether public managers should manage the market, they clearly do so in a variety of ways, often at a high cost.

Endnotes

¹ The sample is drawn from The National League of Cities' Association Management System, which contains contact information from over 40,000 local government officials across the U.S. Surveys were sent via electronic mail and facsimile to a random sample of city managers and a convenience sample of functional specialists representing the directors of human services, information technology, parks and recreation, public works, and inspection services. The sample frame consists of 2,195 local government officials. The dataset currently includes 185 observations, representing a response rate of 8.4%. Data collection is still underway and the results presented in this paper are preliminary. Respondents are underrepresented from cities the Northeast (8%) and overrepresented from cities in western states (41%). Cities with populations over 25,000 were included in the sample frame, and while cities over 300,000 are generally underrepresented (14%), representation is well distributed across small and mid-size municipalities.

² Savas (2002) indicates that even in New York City, where contracts for homeless services might be expected to attract several bidders, three or fewer bids were typical. Of a total of 36 homeless service contracts, 17 attracted only one or two bids (although there was interest from organizations that lacked the requisite qualifications). While other social services might fare better, the fact remains that for many programs, providers are scarce.

³ In some situations, "contracting back in," which eliminates competition altogether (Hefetz and Warner 2004) may be required to best ensure quality service delivery and accountability. Contracting back may be most likely in thin provider markets.

⁴ Factor analysis allows for consolidation of correlated variables into a single variable whereby each observation is assigned a factor score based on analysis of the factor loading for that observation. Eigenvalues are reported as: 1.96 for MM of vendors; 1.51 for MM of bidders; 1.45 for MM opportunity costs.

⁵ City managers, who represent general services, are the reference category in the multivariate regression models.

⁶ The results of the multivariate regression are presented using Ordinary Least Squares (OLS) regression. Because the dependent variables are ordinal, models were also generated using ordered logit models. We found that the significance and direction of the independent variables in the model were unchanged in the ordered logit model; therefore for ease of discussion, OLS coefficients and standard deviations are presented. Furthermore, because many of the independent variables in the model are ordinal (five-point Likert-type scale responses), we created dummy variables for each of the independent variables in the model (e.g. agree and strongly agree coded 1, all else 0; neutral coded 1, all else 0; strongly disagree and disagree coded 1, all else 0). The "agree" and "disagree" dummies were included in an alternate OLS model, using "neutral" as the reference category. Modeling using the dummy variables did not change the significance or direction of the independent variables. Because there was no change, we included the ordinal variables in the final models presented. There is precedence for using ordinal responses for perceptual data (see Fernandez 2009). To test for endogeneity, we also ran Two-Stage Least Squares regression across the three models; no endogenous regressors were found.

Tables

Table 1: Descriptive Attributes

Survey Concept	Percent Agreement
<i>Monitoring</i>	
Sufficient expertise to monitor contracts	69%
Sufficient time to monitor contracts	41%
Subcontractors making monitoring more complicated	67%
Spend more time finding vendors than on oversight	8%
Finding vendors takes time away from oversight	23%
Spend more time helping current contractors than on oversight	6%
<i>Vendors</i>	
Satisfied with number of vendors in the market	50%
More time is spent seeking vendors than expected	24%
Difficult to find high quality vendors	34%
Attempts to find enough vendors often unsuccessful	15%
Resigned to working with few vendors because of failed searches	26%
For current contracts, continue to seek additional vendors for next contract cycle	53%
Contracting policies favor regional/local vendors	48%
Contracting policies favor traditionally disadvantaged vendors	43%
<i>Bidders</i>	
Satisfied with the number of bidders for contracts	65%
Number of bidders for a contract decreases over time	21%
Bidders buy each other out post-contact	15%
Difficult to find high quality bidders	31%
Large numbers of bidders make contract work easier	46%
Resigned to working with few bidders because of failed searches	27%
<i>Contractors</i>	
Mentor contractors to ensure continued bidding	20%
Spend significant time helping contractors improve performance	21%
Trust contractors to adhere to contract terms	71%
Trust contractors to act in good faith	76%
Contractors more interested in bottom line than other goals	45%

Table 2: Distribution of Select Survey Questions

Survey Question	Response
Do you generally support the concept of government contracting?	Yes 179 (97%) No 4 (2%) Don't know 2 (1%)
If you had to choose only one, would you prefer to provide services in-house or contract out?	Contract 44 (24%) Provide in-house 123 (66%) Don't know 18 (10%)
What is the greatest single benefit to your agency/department from its contracts for goods or public service delivery?	Cost savings 65 (35%) Higher quality goods/services 23 (12%) More flexibility in service delivery 57 (31%) More flexibility in staffing 29 (16%) Other 11 (6%)
What is the greatest single drawback to your agency/department from its contracts for goods or public service delivery?	Holding contractors accountable 82 (45%) Loss of in-house expertise 43 (23%) Lower cost savings than anticipated 26 (14%) Other 33 (18%)
In your opinion, what is the optimal number of vendors for any contract?	1: 3 (2%) 2: 6 (3%) 3: 28 (15%) 4: 34 (18%) 5: 62 (34%) 6+: 52 (28%)
Frequency of use: Mixed delivery (some good/service produced in-house and some good/service contracted)	All of the time 11 (6%) Most of the time 62 (34%) Some of the time 88 (47%) None of the time 11 (6%) n/a 13 (7%)

Table 3: Service Cost Reduction- OLS Regression Results

Independent Variables	Coefficients (Standard Errors)
<i>Explanatory Variables</i>	
Market management (MM) of vendors	-0.235*** (0.115)
MM of bidders	-0.188** (0.113)
MM opportunity costs	0.201*** (0.010)
Legal constraints on market	-0.024 (0.079)
<i>Control Variables</i>	
Political influence	-0.036 (0.095)
Agency culture	0.154*** (0.071)
Contract management expertise	0.150*** (0.067)
Perspective on nongovernmental sector	-0.132** (0.071)
Education	0.047 (0.057)
Years in public service	0.001 (0.007)
Building inspection	-0.619*** (0.249)
Health and human services	-0.179 (0.263)
Information technology	-0.609*** (0.230)
Parks and recreation	-0.182 (0.174)
Public works	-0.315** (0.171)
Constant	3.003 (0.608)
Adjusted R-squared	0.202
N = 175	
*p<.15 **p<.10 ***p<.05	

Table 4: Service Quality Improvement - OLS Regression Results

Independent Variables	Coefficients (Standard Errors)
<i>Independent Variables</i>	
Market management (MM) of vendors	-0.218** (0.127)
MM of bidders	0.093 (0.124)
MM opportunity costs	-0.091 (0.111)
Legal constraints on market	0.153 ** (0.088)
<i>Control Variables</i>	
Political influence	-0.055 (0.102)
Agency culture	0.067 (0.079)
Contract management expertise	-0.022 (0.074)
Trust	-0.208*** (0.941)
Education	0.086 (0.063)
Years in public service	0.004 (0.007)
Building inspection	-0.528** (0.275)
Health and human services	0.295 (0.292)
Information technology	-0.206 (0.257)
Parks and recreation	-0.336** (0.193)
Public works	-0.182 (0.192)
Constant	2.583 (0.677)
Adjusted R-squared	0.111
N = 175 cities	
*p<.15 **p<.10 ***p<.05	

Table 5: Public Value Enhancement - OLS Regression Results

Independent Variables	Coefficients (Standard Errors)
<i>Independent Variables</i>	
Market management (MM) of vendors	-0.192** (0.109)
MM of bidders	-0.060 (0.113)
MM opportunity costs	0.046 (0.094)
Legal constraints on market	0.063 (0.075)
<i>Control Variables</i>	
Political influence	0.084 (0.090)
Agency culture	0.073 (0.067)
Contract management expertise	0.154*** (0.063)
Perspective on nongovernmental sector	-0.049 (0.067)
Education	0.095** (0.054)
Years in public service	-0.009* (0.006)
Building inspection	-0.537*** (0.234)
Health and human services	-0.001 (0.247)
Information technology	-0.546*** (0.217)
Parks and recreation	-0.430*** (0.164)
Public works	-0.364*** (0.161)
Constant	2.576 (0.572)
Adjusted R-squared	0.179
N = 175	
*p<.15 **p<.10 ***p<.05	

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