

# **A Practitioner's Guide to Outsourcing**

## **An Opportunity to Improve Cost and Service Quality?**

---

**No. 77**  
**July**  
**2011**

*A Pioneer Institute White Paper*

*by Stephen Lisauskas*





**PIONEER INSTITUTE**  
PUBLIC POLICY RESEARCH


## Pioneer's Mission


Pioneer Institute is an independent, non-partisan, privately funded research organization that seeks to improve the quality of life in Massachusetts through civic discourse and intellectually rigorous, data-driven public policy solutions based on free market principles, individual liberty and responsibility, and the ideal of effective, limited and accountable government.

## Pioneer's Centers

 **This paper is a publication of the Middle Cities Initiative**, which is focused on Medicaid and Health Care budget busters, specifically the cost of Medicaid programs, and long-term care and insurance reforms, cost containment by providing ideas to help businesses, large and small, compete by reducing their health care costs, and tracking the progress of the landmark Massachusetts health care reform.

 **The Center for School Reform** seeks to increase the education options available to parents and students, drive system-wide reform, and ensure accountability in public education. The Center's work builds on Pioneer's legacy as a recognized leader in the charter public school movement, and as a champion of greater academic rigor in Massachusetts' elementary and secondary schools. Current initiatives promote *choice and competition, school-based management, and enhanced academic performance in public schools*.

 **The Center for Better Government** seeks limited, accountable government by promoting competitive delivery of public services, elimination of unnecessary regulation, and a focus on core government functions. Current initiatives promote *reform of how the state builds, manages, repairs and finances its transportation assets as well as public employee benefit reform*.

 **The Center for Economic Opportunity** seeks to keep Massachusetts competitive by promoting a healthy business climate, transparent regulation, small business creation in urban areas and sound environmental and development policy. Current initiatives promote market reforms to *increase the supply of affordable housing, reduce the cost of doing business, and revitalize urban areas*.

*Pioneer Institute is a tax-exempt 501(c)3 organization funded through the donations of individuals, foundations and businesses committed to the principles Pioneer espouses. To ensure its independence, Pioneer does not accept government grants.*

# **A Practitioner's Guide to Outsourcing**

## **An Opportunity to Improve Cost and Service Quality?**

---

Stephen Lisauskas

### Contents

Introduction	1
Benefits and Drawbacks of Outsourcing Services	1
Types of Governmental Outsourcing	5
Factors that Influence Which Services are Outsourced	6
Six Steps to Outsourcing	8
Conclusion	11
About the Author	12
Endnotes	13
Appendix I. Commonly Outsourced Governmental Functions	14
Appendix II. Survey of Delivery of Certain Services in Middle Cities and Other Communities	16
Appendix III. Links to Sample Outsourcing Contracts	17

---

### Introduction

In its most general form, outsourcing is contracting with a third party to provide a service that would otherwise be provided by an organization using its own employees. In a governmental context, outsourcing typically involves the usual governmental procurement procedures – bid development, advertisement and many others – but also involves substantial political considerations given the potential for workforce opposition and the risk that officials who changed a service model will be held accountable for the success or failure of such changes.

Outsourcing can take many forms, including public-to-public outsourcing as well and public-to-private outsourcing. It can also involve the provision of less-visible services such as revenue collection and printing, or more visible services such as water, wastewater, solid waste and grounds maintenance.

Financial limitations on governments have forced a number of municipalities to consider outsourcing in order to continue providing services in an environment of constrained resources. Outsourcing is not appropriate or cost-effective in every situation, but it does provide the potential to reduce costs or improve service quality in many areas. Though political considerations typically militate against such an argument being made, the act of analyzing and potentially outsourcing services is actually consistent with the best principles of public service; to do so is to consider the least costly manner to provide a service to the public. The act of considering outsourcing is part and parcel of ongoing efforts to ensure that services are provided at the desired quality and at the lowest available cost.

Outsourcing does not concern itself with who provides the service – public, private, unionized or non-union employees – but rather focuses on key factors that tend to matter to most residents – is the service being provided effectively, are performance goals being met, and is the cost of

doing so as low as possible. Some residents are likely concerned about which individuals provide services to them, but the financial limitations placed on government by the ongoing recession and growing unfunded capital, pension and health insurance liabilities will only increase the need to focus on the “bottom line” when considering how to provide services to the public.

There is emerging academic literature on the topic of government contracting and outsourcing.<sup>1</sup> This paper does not seek to examine outsourcing from an academic perspective, however, but rather seeks to be a practitioner's guide to the issue. In doing so, this paper outlines important managerial and political considerations that may help leaders evaluate the potential of outsourcing services.

This paper will explore many of the benefits of outsourcing such as:

- Cost savings
- Access to specialized knowledge, capital, and technology
- Focus on service outputs instead of inputs
- Ability to measure improvement
- Shift of liability and
- Support of local companies

It will also discuss challenges to outsourcing such as:

- Difficulty in defining outcomes
- Writing and managing contracts
- Collective bargaining and
- Political hurdles

### Benefits and Drawbacks of Outsourcing Services

It is not appropriate to outsource every governmental function, and not every service will be outsourced successfully in every municipality even if it is appropriate to do so. That being said, there are a number of potential benefits that can be achieved through outsourcing.

*Benefits of Outsourcing*

Outsourcing can reduce costs relative to public sector service provision. It is estimated that outsourcing grounds maintenance and lawn mowing services in one Middle City<sup>2</sup> reduced the cost of this service by 75%; outsourcing the management and processing of worker's compensation and injured on duty services reduced the cost of these services by well over 80% due to improved processing, oversight and control. Financial savings are often possible through elimination of unnecessary staff; through the ability to access lower private market wage and benefit rates; and by receiving the benefit of the capital assets, operating techniques and knowledge of external parties who specialize in particular services.

---

Outsourcing often involves market competition for services. This provides public sector agencies the opportunity to access more modern, flexible approaches to providing a service than may not have evolved through internal service provision.

---

Outsourcing often involves market competition for services. This provides public sector agencies the opportunity to access more modern, flexible approaches to providing a service than may not have evolved through internal service provision. One Middle City reports that outsourced street sweeping used 1.5 fewer staffers and 1.5 fewer pieces of equipment per work crew than was the case when the service was provided in house. In addition, private contractors determined that an hour and a half each day was being wasted per street sweeper by driving them to and from their central storage facility each day. Sweeper productivity was increased by nearly 20% for each work crew, assuming an eight hour work day, just simply by identifying locations to securely store street sweepers in the field. These and

other improvements were the result of applying specialized knowledge to a particular set of services which otherwise were being provided by the municipality in the same manner as they had been for many years.

Public agencies manage outsourced services differently than they manage services provided by public employees. In order to manage in-house service provision, public managers must hire and manage personnel, address labor issues and ensure sufficient staff is on hand each day who are appropriately trained. They must ensure necessary and adequate equipment and supplies are also available to provide the service in question. Outsourcing allows municipal managers to shift these responsibilities to a contractor. In addition to this, however, municipalities can often receive the right to financially penalize a contractor which fails to provide sufficient and qualified staff or fails to meet performance expectations. This is an added level of insurance which is not available if public employees fail to meet service expectations.

Outsourcing allows managers to focus on measuring and managing outcomes rather than on dealing with significant input issues. These input issues are typically complicated and time-consuming given the many laws, regulations, collective bargaining provisions and financial challenges under which municipalities operate. As a result, a focus on outcomes – and the public reporting and discussion of these outcomes – is often underemphasized or absent when municipalities provide services using internal resources. Outsourcing improves the likelihood that municipalities can focus on what truly matters to many recipients of public services – are school children being fed appropriately, is trash being removed, are schools clean and safe – rather than focusing their time and effort on planning for and managing the inputs used in service provision.

In addition to shifting personnel management, capital investment and equipment maintenance to the contractor, outsourcing often allows

## ■ A Practitioner's Guide to Outsourcing

municipalities to shift liability to contractors. If a government employee is pruning a tree and a limb falls on a car, the municipality is typically liable for damages. If a private contractor is providing this service, however, a municipality will often have the right to subrogate the liability for this damage to a contractor, providing additional protection to the taxpayers in the event of error. Outsourcing also allows municipalities to shift the cost of unemployment benefits, workers compensation and other items to the contractor, generally reducing the direct cost of these items to the taxpayers.

---

Outsourcing allows managers to focus on measuring and managing outcomes rather than on dealing with significant input issues.

---

Outsourcing also allows many municipalities to achieve a higher economy of scale than would otherwise be possible if they provided a service themselves. This can reduce costs and provide additional service features that otherwise would not be available, such as access to technology or expensive equipment that can reduce service time, improve quality or reduce employee risk. Outsourcing also gives public agencies access to knowledge and experience that would otherwise not be available to them. While every municipality is unique, the services they provide are often quite similar. Given the low degree of employee transfer from one municipality to another, innovative techniques are not spread quickly through public agencies. Outsourcing can provide a municipality access to the experience of individuals who have provided the identical service in many other jurisdictions, thereby providing the opportunity to improve services in areas where a municipality has not maintained currency with best practices.

Contracting with private entities to provide services can also build or benefit local businesses. Outsourcing can provide a boost to a growing

company, allowing it to expand, serve more customers outside of its geographic area, and potentially import additional income into the local economy. This can have marginal financial benefits for municipalities – it may help stabilize real estate values by helping a company succeed or may increase excise tax revenues by allowing a local company to purchase new vehicles. Additional study would be required to analyze the value of this economic benefit compared to the economic benefit of employing more municipal employees, however.

Though difficult to quantify, the potential to outsource services could also provide a competitive benefit even if public service provision remains in place. Competitive pressures themselves could potentially reduce the cost and improve the quality of municipally-provided services.

---

Outsourcing also gives public agencies access to knowledge and experience that would otherwise not be available to them.

---

### *Challenges of Outsourcing*

While outsourcing has a number of potential benefits, there are also potential challenges to using this service delivery method. Outsourcing is not appropriate for every service. Services that are difficult to define and whose outcomes are difficult to quantify are generally difficult to outsource. Seeking private competition for these services could potentially be unproductive or result in higher costs if the work is not properly defined or if outcomes are improperly measured.

Successful outsourcings require strong management oversight, as contracts with vendors must be regularly monitored and enforced. This is potentially a different set of skills than possessed by existing municipal managers who have focused on personnel, capital and equipment (input) management. This can also create a difficult

political dynamic of hiring more managers and supervisors in order to lay off laborers, clerical employees and other line staff.

A well drafted procurement document and contract is critical to a successful outsourcing. This concentrates risk in discrete events that could be handled in error and, with multiyear contracts, could disadvantage a municipality for some time to come. Internal service provision is comprised of many smaller tasks – hiring, training, assigning and conducting work, ordering materials and supplies, etc – that can better tolerate errors because one mistake does not necessarily prevent a department from functioning. While problems are more likely given the large number of decisions, internal service models allow for greater flexibility because there is no need to renegotiate the terms and conditions of a contract with a vendor to make a change.

---

Outsourcing is not appropriate for every service. Services that are difficult to define and whose outcomes are difficult to quantify are generally difficult to outsource.

---

Outsourced services can also be less flexible than in house services. Though limited by the terms and conditions of collective bargaining agreements, employers can, in certain circumstances, shift employees to other functions depending on the needs of the department in which they work. Laborers can be assigned to rebuild storm water drains on Monday and then to solid waste removal on Tuesday. This is not often the case with an outsourced service.

This limitation speaks to the need for good data about municipal services prior to conducting an outsourcing. Under normal operations, departmental managers should know how many staff and how much equipment is required for each function. This would then address some of

the need to “flex” employees across functions as the remaining internal services could be staffed to meet their own needs, and vendors would be required to meet performance goals regardless of how many staff they needed to perform the task. To the extent departments lack this data, however, outsourcing can cause some uncertainty between the municipality and the vendor as the contractor “figures out” the services which the public agency was not able to fully describe.

In instances of limited data, outsourcing a service can be a key component in developing needed data and professionalizing service delivery; vendors typically capture and use significant information about the services they provide, and outsourcing can be used to develop and provide that data if a department is incapable of doing so itself. This data would help in the operation of the particular service but also would be beneficial in future outsourcings or if a municipality chose to resume in-house service provision.

Outsourcing can create a risk that a municipality becomes reliant on external service partners, increasing the cost and difficulty of changing vendors or in-sourcing services. This is not a risk in most cases – it is relatively easy to find a different vendor to cut grass or, alternatively, to purchase equipment and hire staff to do so. There are instances in which in-sourcing a service comes at great difficulty or cost, however. An example would be the need to in-source school busing services if a municipality was unable to find a vendor willing to provide this service at a reasonable cost. While it would not be difficult to hire staff to conduct this work, acquiring and storing school buses could be an expensive or difficult endeavor, especially on short notice. Given that most services do not feature this risk, the risk of become “stranded” with an external partner should be considered but only viewed as a potential impediment in instances where the competitive market is small and the barriers to market entry – by other vendors or the municipality – are high.

## ■ A Practitioner's Guide to Outsourcing

The most difficult challenge with regard to outsourcing is often political risk. External service provision may be opposed by employees and potentially by residents who believe non-residents or non-employees can not meet their particular service needs. This can create opposition among policymakers – mayors, city councilors and select boards – who must approve external service provision. Policymakers may also be concerned that outsourcing a service will make them personally responsible for the outcome of this service; it is often possible to diffuse political responsibility for poor performance to the employees who provided bad service, but it is more difficult to do this for policymakers who decide to outsource a service to an external service provider who then provides poor service.

---

The most difficult challenge with regard to outsourcing is often political risk.

---

It may be appropriate to address these political concerns by engaging in the outsourcing process and inserting an additional decision point after bids are received. It is difficult to determine if outsourcing is appropriate or inappropriate until all data – cost, quality standards, reference checks, etc. – is received and can be considered as part of a single package. As such, it may be appropriate to focus political considerations into a time period after data is received and analyzed, and thoughtful discussions can be conducted. Though it may be the goal of the political process to prevent this analysis from being conducted, failing to conduct this analysis would deprive taxpayers of the potential opportunity to reduce the cost of government or improve the quality of services they receive. It would also prevent the municipality from learning more about the services it provides through the bid development process and through vendor bid responses that propose improved management or operational techniques.

Outsourcing service provision to other public agencies – whether to a neighboring municipality, a special district, a regional government or a state agency – can avoid a number of potential drawbacks of outsourcing. Profit motivation is significantly reduced, and some members of the public have greater confidence that certain services will be performed better by public employees than by private companies. Public agencies also tend to pursue the public good which can be advantageous when confidentiality issues are important, when a contractor would have a significant knowledge advantage over the municipality or when transactions are complicated or involve potentially large sums of available money. Outsourcing to another public agency may reduce innovation and cost savings, however, as public agencies generally do not face private market competition and typically lack the incentive to innovate and improve to remain in business.

---

While private sector outsourcing is often associated with the manufacture of goods in low-cost nations or off-shored service provision, public services tend to rely heavily on people who are present in a particular location. Government outsourcing typically involves using domestic service production – often local service provision.

---

### **Types of Governmental Outsourcing**

There are a variety of ways for municipalities to outsource services. While private sector outsourcing is often associated with the manufacturing of goods in low-cost nations or off-shored service provision, public services tend to rely heavily on people who are present in a particular location. Government outsourcing typically involves using domestic service production – often local service provision – but



uses different staff or different service models to deliver these services.

#### *Outsourcing to the Private Sector*

Many municipalities outsource services to the private sector. This is perhaps the most commonly understood model of outsourcing. In these instances, private employees provide services that governmental employees would otherwise be required to deliver. Examples range from the provision of core services, such as residential solid waste collection and disposal, to the provision of services that are rarely needed, such as demolition services. The profit motivation of the private sector builds in some inefficiency – money that becomes profit is not used to provide services – but the desire for profit can lead to innovations and increases in efficiency beyond what can be accomplished in the public sector alone. This can provide sufficient available resources for both profit and for a reduced cost of the service when compared to public service provision.

#### *Outsourcing to Another Government*

Different governments – whether they be another municipality or a State government agency – provide services at different cost points and at different levels of quality. To the extent that these governments are aware of the full cost of providing these services and communicate these to each other, governments can select the best provider to maximize service at the lowest cost. Examples of this include the growing number of municipalities which purchase health insurance through the Commonwealth of Massachusetts' Group Insurance Commission.<sup>3</sup> As another example, a municipality outside of Boston has outsourced responsibility for selling its recyclable materials to another local government which operates a highly effective municipal recycling service.

#### *Outsourcing to a Regional Government*

A variety of regional government agencies – from the Massachusetts Water Resources Authority

to the regional Springfield Water and Sewer Commission – provide services to municipalities. Common examples include regional water and sewer districts that spread over a larger base of customers the capital cost of water and sewer treatment. This type of service arrangement can be especially helpful when important components of a service – locating water wells and sewage treatment plants – are expensive or difficult to site.

Other examples include services which are provided in nearly identical manners by different municipalities – such as purchasing in Massachusetts, where procurement processes are stipulated in law. The Metropolitan Area Planning Council has entered into a variety of cooperative purchasing agreements for a number of important municipal tools and equipment, including public works materials, police vehicles and, recently, standardized fire suppression apparatus. This allows municipalities to take advantage of volume pricing while avoiding the cost and liability associated with developing their own bid specifications and conducting their own procurement processes.

#### *Outsourcing to a Non-Profit Agency*

Public agencies also outsource functions to non-profit agencies. A number of school districts contract to provide out-of-district services to special needs students and to provide supplementary educational services such as English language immersion and others. An additional example includes the recreational and enrichment services provided by the Forest Park Zoological Society under contract with the City of Springfield.

### **Factors that Influence Which Services are Outsourced**

There are a variety of factors that determine which services can be outsourced, and which of these can be successfully conducted. Municipal governments provide many services,

## ■ A Practitioner's Guide to Outsourcing

some relatively straightforward and others more difficult to quantify. Services tend to be candidates for outsourcing when they can be easily defined and when performance is easily measured and quantified. This dynamic can be observed when one considers the relative ease of defining and measuring solid waste removal services – routes can be defined, tonnage measured and poor performance (that is, missed pickups) are easily observed and remediated. Compare this with the relative difficulty of defining and measuring police protection, where changes in criminal activity may or may not be the result of a contractor's actions. This makes it more difficult to outsource policing services, for instance, because it is difficult to define, and therefore enforce, meaningful performance standards.

### *Cost Reduction*

For services that are easily defined and for which work output is easily measured, outsourcing is often appropriate when cost is a key consideration. Cost characteristics that often drive outsourcing decisions include:

Capital costs – services which have high capital costs are generally candidates for outsourcing. Outsourcing allows these costs to be spread across many customers, such as when water and sewer services are regionalized to increase the number of people paying for treatment facilities. Similarly, services that require specialized or single-purpose equipment may also be more easily outsourced. This includes demolition services and street sweeping in smaller communities, as well as services that require rarely-used bucket trucks, food preparation equipment and others.

Wage rates – public wage rates – including benefits – can exceed private market wage rates for lower wage positions.<sup>4</sup> As such, it is often cost-beneficial to outsource janitorial services, mowing and field maintenance and other labor services. Similarly, many office functions are commonly performed by all municipalities – revenue collection, for instance – and can be

outsourced to improve control and reduce costs.

Some states have adopted anti-competitive measures that make it more difficult for government agencies to benefit from lower wage opportunities provided in some private sector industries. These include so-called prevailing wage statutes which set higher wage rates for public projects and so-called “responsible employer ordinances” which require government contractors to offer health, retirement and other benefits, even when these benefits are not commonly found in relevant private sector employment markets. While often reflective of a social policy perspective – it is better to pay employees more and provide benefits to them – doing so forces taxpayers to pay higher costs for services which they could otherwise receive at lower cost. This increases the amount of tax residents would otherwise be required to pay or forces government to provide fewer public services using the same amount of money. This paper does not opine on these policy matters but simply observes that they increase the cost of outsourcing and can be anti-competitive by favoring certain classifications of employees over others.

Benefit costs – public sector employees are generally provided generous health, pension, leave time and other benefits. Historically, benefits have been expanded because wage rate growth was more constrained in the public sector than in the private sector. As mentioned above, emerging trends indicate that public and private wage rates have achieved parity across a number of professions, though benefit levels remain higher in the public sector.

Health insurance is provided to many public sector employees, but the cost of this benefit more than doubled for Massachusetts municipalities between 2001 and 2008.<sup>5</sup> Contracting with private agencies to provide services allows municipalities to avoid paying for benefits which have become more expensive over time, and which have contributed to substantial unfunded pension and other post-employment benefit liabilities.

Outsourcing services allows municipalities to cap pension and health insurance liabilities for employees whose positions may be transferred to a private contractor, thereby reducing long-term costs for the taxpayers.

Shedding liability – it is often appropriate to consider outsourcing services which have high risk of injury or property damage. This is not universal, however, as police protection is a high-risk activity but is difficult to outsource because success is hard to define and measure.

Contracting for high-risk services with an organization that specializes in this work can reduce employee and property risk, as necessary training and safety apparatus are more likely to be in place, and the culture of the organization is likely to be more attuned to safety and risk mitigation. Contracting for these services also allows the risk of loss to be shared with a private entity whose insurance policies can provide additional protection to a municipality in the event of loss.

#### *Access to Specialized Skills and Knowledge*

It is also appropriate for governments to outsource functions when they need specialized skills or knowledge, especially when it is not cost effective or it is impractical to maintain these services in-house.

Many municipalities in Massachusetts outsource Medicaid billing for school health services. Medicaid billing is a highly-specialized service that would require municipal employees to maintain high levels of specialized knowledge. This is often difficult for local governments to do, as training resources are limited and employees are often asked to assist in other areas of the organization. This takes time away from work that would maintain and upgrade the specialized skills needed to excel in these types of services. Municipal management of these services also requires appropriately-trained managers who can oversee these services to ensure work is being done properly. These all represent high-cost

items that have higher risks of failure in the public sector given the difficulty of funding ongoing training and professional development programs. Specialized skills are often highly prized in the private sector, creating the potential that public sector entities will be unable to retain employees with specialized skills because they will be hired away by the private sector where compensation levels are higher for employees with high-value skills.

#### *Access to Additional, Temporary Workforces*

Outsourcing is often appropriate – and may be required – for services that include temporary increases in employment levels. Examples of this include supplemental snow plowing operations and the construction of roads, bridges and tunnels at the state level. It would not be cost-effective for public agencies to maintain a large numbers of employees to address occasional heavy snowfalls, or to maintain a large staff of bridge designers, engineers and construction workers to conduct periodic road, bridge and tunnel work.

#### *Increase Workforce Flexibility*

Union work rules and contentious labor/management relationships can negatively impact the management and operation of municipal departments. Long mandatory notification periods prior to layoffs, the inability to restructure a department to meet service needs, resistance to retraining, resistance to removing employees who perform poorly, abuse of sick and other leave time, and many other issues can lead managers to consider outsourcing services as a way to reduce the managerial cost and difficulty of providing public services. As stated previously, it can be easier to manage a contractor toward specific performance goals rather than manage the “input issues” associated with an agency’s workforce, capital infrastructure and equipment. In these instances, outsourcing may be considered an appropriate step to reduce the cost and risk of managing government services.

## Six Steps to Outsourcing

A successful outsourcing requires leadership commitment and the early and public identification of the goals that the outsourcing seeks to achieve. The current cost to provide the service and the level of quality currently achieved should be agreed upon prior to outsourcing to ensure stakeholders are able to make clear evaluations of the performance of the entity selected to provide the service.

---

A successful outsourcing requires leadership commitment and the early and public identification of the goals that the outsourcing seeks to achieve.

---

1) Determine what you wish to outsource – as discussed, a number of services are natural candidates for outsourcing if they are more expensive or more difficult to provide internally, and if their results can be easily quantified and managed through a contract for services. A proposal to outsource a service should be specific as to which service is involved, how much of that service is to be outsourced and in what manner the outsourcing will proceed. This would include decisions regarding side-by-side public and private service provision, outsourcing only a part of the service, and the potential means of outsourcing (public-to-public, public-to-private, public-to-non-profit outsourcing). In many instances it may be appropriate to involve elected officials and stakeholders in the consideration of these issues to ensure they are informed and to improve the chances of a successful outcome in the future.

2) Market analysis – an important factor in a successful outsourcing will be the availability of a sufficient private or other marketplace to provide desired services. Services that rely on only one or two potential vendors can be more expensive and bring less innovation to an outsourcing. Lack of competition can also force a municipality to

remain in an unsuccessful contract because it can not easily cancel a contract and engage another vendor. As discussed, an important corollary to this would be an analysis of a municipality's ability to in-source the service if necessary, including the availability of land, capital, equipment and staff, as appropriate.

There are instances in which weak market participation may not be a significantly negative factor, though it may tend to drive up cost. There are likely to be fewer vendors offering highly capital-intensive services such as financial management computing systems, payroll systems, student busing and others, though experience suggests that municipalities can still improve the quality and reduce the cost of public services by contracting with external parties rather than developing these services in-house.

---

[1] It is critical to establish clear cost and quality baselines prior to outsourcing a service. This will allow for more thoughtful analysis of the outcome of the outsourcing, reinforcing the results of good outsourcings and providing important feedback on outsourcings that may be less successful.

---

3) Establish baselines for cost and quality – as discussed above, it is critical to establish clear cost and quality baselines prior to outsourcing a service. This will allow for more thoughtful analysis of the outcome of the outsourcing, reinforcing the results of good outsourcings and providing important feedback on outsourcings that may be less successful.

As one example of the importance of establishing baselines, a Middle City outsourced evening-shift janitorial services, saving an estimated \$2 million per year. After a summer of work by the contractor, some buildings that were thought to have brown floors were actually found to

have white floors because years of accumulated dirt and floor wax was removed. This positive experience was replicated in other areas but opponents of the outsourcing were able to raise doubts about the quality of the contractor's work because baselines were not established for comparison purposes. It should also be noted that, as time passes, employees and residents will become accustomed to the level of service provided to them. Even in instances of poor service prior to outsourcing, residents, employees and policymakers may forget that service was poor prior to the outsourcing. Clear and public baselines can help manage these perception and political issues.

4) Development of bid specifications and performance measures – bid specifications must be clear and should stipulate performance standards and measurement tools in detail. Assuming stakeholders who participate in the process may wish to retain in-house service provision, it may be appropriate to require that services retained in-house be subject to the same performance expectations that were developed for potential external service providers. In this way, the core goal – serving the taxpayer in the best possible way – would be preserved and ongoing analysis of costs and outputs would be possible.

Bid specifications should define in detail the services being considered for outsourcing to ensure all parties have a clear understanding of the services involved. This will also help external service providers offer the lowest possible price to the municipality. Uncertainty creates the opportunity for misunderstanding in the future and will cause vendors to offer higher prices to protect them in the event they need to apply more resources to a particular project. Specifications should also include agreed-upon timeframes for status updates and performance reviews, a discussion of the performance metrics and the means to be used to measure performance against these standards, and a process to update performance measures and evaluation tools during the contract period. Bid specifications

should also include a stipulated time period in which poor performance – a missed trash pick-up, for instance – must be addressed.

It is important to ensure that bid specifications are developed by personnel who understand the service at a management and operational level. Care should be taken to ensure these personnel do not seek to frustrate the outsourcing by issuing opaque performance measures, specifying non-standard procedures to create a disincentive for firms to bid, or to take other actions that can harm the evaluation process. While these issues can be resolved and an outsourcing can be rebid, a first failed bid can provide a disincentive for firms to participate in a subsequent procurement because of the time and money they wasted on the first procurement.

5) Develop a strong contract – a strong contract will flow directly from a good procurement document and will stipulate minimum performance standards, cancellation clauses and financial penalties for failure to meet performance expectations. Consideration should be given to requiring that all data collected by the contractor be provided to the municipality on a regular basis to ensure the municipality maintains a robust knowledge of the service even though it is not directly providing it.

The contract should include a feedback loop – a complaint process – through which a municipality can address day-to-day operational issues such as missed trash pick-ups, classrooms that were not cleaned and glitches in a computer system. This feedback loop should maintain records of historical data that can be analyzed by the municipality to look for trends and patterns. In addition to this, the contract should require regular meetings between the municipality and the contractor to discuss performance, identify roadblocks and potential problems, and get immediate action on issues. It may also be appropriate to require regular meetings with policymakers and stakeholders to ensure continued communication with those who are directly impacted by the contractor's work.

## ■ **A Practitioner's Guide to Outsourcing**

The contract itself should be administered by a municipal employee who is sufficiently assertive and detail-oriented to ensure a contractor complies with all contract provisions. Effective contract administration will increase the probability of success and will likely reduce costs by addressing problems early. Proactive management will also help a municipality learn if a contractor is truly interested in providing quality services to residents, an important consideration in the management of a contractor relationship.

6) Ongoing management – senior management should maintain direct oversight of an outsourced service for a period of time to ensure problems are being addressed and the contractor is receiving appropriate cooperation from municipal agencies. This will improve overall contract performance, identify and resolve problems early and allow each party to work toward an improved outcome.

Management should also monitor the complaint process to ensure the vendor is complying with the contract, but also to ensure the system is not being abused by employees in an attempt to undermine the outsourcing. Examples of such activities include filing false or vague complaints designed to waste vendor resources and creating the appearance of a large number of non-existent operational issues.

It will be important to address operational and other issues promptly and communicate them to policymakers to ensure the performance of the outsourcing can be appropriately evaluated. It is also recommended that management spot-check work to ensure the contractor knows of management's involvement and to ensure management has personal exposure to the quality of work being performed.

A municipality should consider requesting access to a vendor's work order system – or integrating the vendor into the municipality's work order system – to ensure important performance, cost and maintenance data is available to the municipality at all times. This will also provide important information when the contract to

provide this service is again put out to bid or in the event that the work is in-sourced.

### **Conclusion**

Outsourcing provides significant opportunities for municipalities and other governments to reduce costs and improve the quality of services provided to taxpayers and residents. Competition is likely to improve the quality of municipally-provided services, even if they are not outsourced. Private sector service delivery will bring best practices to bear to improve the quality of services. This can also reduce immediate- and long-term costs through better pricing and by avoiding pension and other-post employment benefit liabilities. Key to a successful outsourcing is the delineation of a clear scope of work, development of appropriate performance standards, and the use of valid performance evaluation techniques. Strong contract administration and management oversight will also contribute greatly to the success or failure of a potential outsourcing.

Outsourcing is not a tool that can be used in all instances, or used successfully in all municipalities, but it can provide significant benefits to governments that use it, and even to governments that simply use it as a vehicle to analyze and improve the services they provide themselves.

***About the Author:***

Stephen Lisauskas is Pioneer’s Senior Fellow on Urban Revitalization. Stephen’s work focuses on helping cities and towns reduce costs, develop performance management and improvement systems and improve financial management and operational efficiency.

Stephen served for two years as Executive Director of the Springfield Finance Control Board and one year as its Deputy Executive Director. In these roles, he oversaw the finances and day-to-day administration of a city with 7,000 employees, a \$643 million operating budget and \$260 million in ongoing capital investment. Stephen holds a Master Degree of Public Administration from the Maxwell School of Citizenship and Public Affairs at Syracuse University and a Bachelor’s Degree in Political Science, also from Syracuse University.

***About Pioneer:***

Pioneer Institute is an independent, non-partisan, privately funded research organization that seeks to improve the quality of life in Massachusetts through civic discourse and intellectually rigorous, data-driven public policy solutions based on free market principles, individual liberty and responsibility, and the ideal of effective, limited and accountable government.

**Recent Pioneer Publications**

*Houses of Learning: The Charter Public School Facilities Process*, White Paper, June 2011

*Business Solutions to the Health Care Crunch: Innovations in Health Care Insurance Plan Design*, White Paper, June 2011

*METCO Merits More: The History and Status of METCO*, White Paper, June 2011

*The Big Shrink: Declining Establishment Size in Massachusetts*, White Paper, May 2011

*Testimony to the Joint Committee on Health Care Financing*, Public Testimony, May 2011

## Endnotes

1. Professors Trevor Brown (Ohio State University), Matthew Potoski (Iowa State University) and David Van Slyke (Maxwell School of Citizenship and Public Affairs, Syracuse University) have all conducted research and written on issues of government contracting and outsourcing.

2. Pioneer has been working with 14 “Middle Cities”—with populations greater than 40,000, income per capita of less than \$20,000, and EQV (a measure of property value) per capita of less than \$80,000—to support greater civic engagement. The Middle Cities Initiative works with mayors, city managers, and citizens to create and disseminate clear information on city performance in education, economic development, public safety, and fiscal management.

3. The Group Insurance Commission reports that twenty municipalities currently participate in its health insurance program. These communities are the cities of Springfield, Pittsfield, Quincy, Melrose and Lawrence and the Towns of Brookline, Groveland, Holbrook, Hopedale, Millis, Norwood, Randolph, Saugus, Stoneham, Swampscott, Watertown, Wenham, Weston, Weymouth and Winthrop.

4. *Public and Private Sector Compensation: What is Affordable in This Recession and Beyond – A Conference Summary*, Chicago Fed Letter, Number 262a, The Federal Reserve Bank of Chicago, May 2009

5. *Municipal Financial Data*, 39th edition, November 2009, Massachusetts Taxpayers Foundation, pages 3-4

6. *The Town of Natick Emergency Medical Services Report* (February 22, 2010) recommended not privatizing ambulance services in a town which has public ambulance provision. The report *Proposed Fire Department-Based Basic Life Support Ambulance Service, Preliminary Report: Key Findings & Recommendations* (May

22, 2006) recommended maintaining private ambulance services in Chelmsford, MA.



## **Appendix I. Commonly Outsourced Governmental Functions**

Some services are outsourced by governments more frequently than others. For many of the services below, it may be the case that larger governments are less likely to outsource these operations given the fact that their large size allows them to achieve some economy of scale on their own. The services highlighted below are a few examples of commonly-outsourced municipal services. They have been selected to highlight the factors that typically influence the decision to outsource them. These factors are italicized for ease of reference.

Core computing systems – core computing services – such as financial management systems, payroll systems and others – tend to be provided by private entities given the high cost of developing and maintaining these systems. In Massachusetts, the Munis financial management software system is widely used and is regularly updated with new or improved functionality based on user feedback. Given the cost and technical issues, outsourcing these services may be the only way for some municipalities to develop a core financial management system. Participants in these systems also receive the benefit of the implementation, maintenance, and training expertise of the outsourced provider and the combined experience of other public financial managers as reflected in the design and ongoing refinement of the system. This benefit is not available to custom-built systems or where particular private systems do not have broad usage.

Solid waste collection and disposal – solid waste collection and disposal generally involves significant capital costs and the maintenance of expensive equipment. This service also carries risk as environmental laws and regulations regarding landfills, incinerators and other means of disposal can have significant financial implications or result in fines or other regulatory action. These services also tend to include significant long-term

costs, as, for instance, landfills must be closed and monitored for years afterward. Solid waste collection and disposal also tend to have higher rates of employee injury if more advanced – and more expensive – collection equipment is not used. Outsourcing this service may also allow municipalities to take advantage of potentially lower wage rates in the private sector, thereby reducing the cost of this service. This would allow financial savings to be invested in other public services, in reducing unfunded liabilities or in lower tax rates.

Tree Maintenance – tree maintenance is a high-risk activity that uses significant, limited purpose capital assets such as log loaders, chippers, stump grinders and others. In certain climates, these assets can only be used for limited periods of time due to weather conditions. The risk of employee injury is also significant, and includes falls from trees and cutting and eye injuries. As discussed above, outsourcing allows this function to be conducted by a business entity that specializes in tree maintenance – and is therefore more likely to work safely and to purchase necessary equipment to do so – rather than asking a municipal department to do this work as a small part of its portfolio, with necessary equipment competing for scarce resources with police and fire apparatus, educational facilities and other needs.

Water and wastewater – water and wastewater services are often outsourced to other governments. In Massachusetts, communities in Greater Boston typically receive water and/or wastewater services from a public authority. In other instances, communities share water or wastewater treatment services to spread capital costs across a larger base of customers. Doing so also takes advantage of the inherently scalable nature of this service and the fact that residents may not wish to live near a water or wastewater treatment facility. This can make politically more attractive to contract to use an existing facility rather than building one a new one.

## ■ **A Practitioner's Guide to Outsourcing**

Ambulance services – many municipalities outsource ambulance services to provide residents access to highly-skilled emergency medical services and specialized medical transportation. A number of fire departments have expanded to provide these services as governmental functions in recent years. Studies conducted by municipalities have found municipal ambulance service to be both more and less cost effective than privatized provision, depending on the community in question.<sup>6</sup> This represents an area for future study.

Legal services – many municipalities outsource their law departments, in whole or in part. Large and small municipalities typically outsource specialized legal services, such as cable television contract negotiations, and litigation and labor law. Some municipalities outsource all legal services because their need for legal resources is too small to justify a full-time attorney, or to take advantage of the diversity of talent and larger supply of staff that can be found when contracting with a larger firm.

Towing and vehicle storage – many municipalities outsource motor vehicle towing and storage. Smaller agencies may lack the volume of work in this area to justify the purchase of a tow truck and development of appropriate storage facilities. Larger communities may seek to outsource this service to shed liability and avoid managing compliance issues that can arise in motor vehicle towing and storage.

**Appendix II.**  
**Survey of Delivery of Certain Services in Middle Cities and Other Communities**  
**(survey of communities January through May 2011)**

	Population	Ambulance	Computing - Financial	Legal	Solid Waste Collection	Solid Waste Disposal	Wastewater	Water
Amherst	37,819	Municipal	Outsourced	Outsourced	Not Provided	N/A	Municipal	Municipal
Bourne	19,754	Municipal	Outsourced	Municipal	Municipal	Municipal	Small Section, Multi-Community	Independent governments (3)
Brockton	93,810	Outsourced	Outsourced	Hybrid	Outsourced	Outsourced	Municipal	Municipal
Chicopee	55,298	Municipal	Outsourced	Municipal	Municipal	Outsourced	Municipal	Municipal
Danvers	26,493	Outsourced	Outsourced	Outsourced	Outsourced	Outsourced	Municipal	Multi-Community
Fall River	88,857	Municipal	Outsourced	Municipal (rare hybrid)	Municipal	Outsourced	Municipal	Municipal
Fitchburg	49,318	Hybrid	Outsourced	Hybrid	Outsourced	Municipal, Multi-Community	Multi-Community	Multi-Community
Haverhill	60,879	Hybrid	Outsourced	Hybrid	Outsourced	Outsourced	Municipal	Municipal
Hull	10,293	Municipal	Outsourced	Municipal	Not Provided	N/A	Not Provided	Outsourced
Lawrence	76,377	Outsourced	Outsourced	Hybrid	Outsourced	Outsourced	Regional government	Municipal
Leominster	40,759	Hybrid	Outsourced	Outsourced	Outsourced	Outsourced	Hybrid	Hybrid
Lynn	90,329	Hybrid	Outsourced	Hybrid	Outsourced	Outsourced	Regional government	Independent government
Milton	27,003	Outsourced	Outsourced	Outsourced	Outsourced	Outsourced	Regional government	Regional government
Natick	33,006	Municipal	Outsourced	Outsourced	Municipal	Outsourced	Regional government	Municipal
Lowell	106,519	Outsourced	Outsourced	Hybrid	Outsourced	Outsourced	Multi-Community	Multi-Community
Pittsfield	44,737	Outsourced	Outsourced	Outsourced	Outsourced	Outsourced	Multi-Community	Multi-Community
Sandwich	20,675	Municipal	Outsourced	Outsourced	Drop-off	Outsourced	None	Independent government
Scituate	18,133	Municipal	Outsourced	Outsourced	Drop-off	Outsourced	Municipal	Municipal
Springfield	152,060	Outsourced	Outsourced	Hybrid	Municipal	Outsourced	Regional government	Regional government
Taunton	55,874	Outsourced	Outsourced	Hybrid	Outsourced	Outsourced/ Hosted	Municipal	Municipal
Westborough	18,272	Municipal	Outsourced	Hybrid	Outsourced	Outsourced	Hybrid, Multi-Community	Hybrid
Worcester	181,045	Outsourced	Hybrid	Hybrid	Municipal	Outsourced	Municipal	Municipal

Definitions

Municipal: Services provided using municipal employees as well as municipally-owned capital assets, where needed.

Outsourced: Services provided by non-public sector personnel and capital assets, where needed.

Hybrid: Services provided by a mixture of public and private sector employees and/or capital assets, where needed

Multi-Community: Services provided via a multi-community compact

Regional Government: Services provided by a regional government such as the Massachusetts Water Resources Authority.

Independent Government: Services provided by an independent local government, such as a public water or fire district.

Source: Author's collection of data.

## **Appendix III. Links to Sample Outsourcing Contracts**

### **School Food Service Program**

Sample contract for school food service program:

[http://pioneerinstitute.org/pdf/110706\\_Outourcing\\_SodexoYr1.pdf](http://pioneerinstitute.org/pdf/110706_Outourcing_SodexoYr1.pdf)

Sample amendment to for school food service program contract:

[http://www.pioneerinstitute.org/pdf/110707\\_Outourcing\\_SpringfieldContract0335\\_06.PDF](http://www.pioneerinstitute.org/pdf/110707_Outourcing_SpringfieldContract0335_06.PDF)

### **Affirmative Action/Equal Opportunity**

Sample affirmative action/equal opportunity and programmatic access plan:

[http://pioneerinstitute.org/pdf/110706\\_Outourcing\\_AffirmativeAction.pdf](http://pioneerinstitute.org/pdf/110706_Outourcing_AffirmativeAction.pdf)

### **Custodial Services**

Sample amendment to school custodial services contract:

[http://pioneerinstitute.org/pdf/110706\\_Outourcing\\_amendment\\_1\\_CityContract.pdf](http://pioneerinstitute.org/pdf/110706_Outourcing_amendment_1_CityContract.pdf)

Sample contract for school custodial services:

[http://www.pioneerinstitute.org/pdf/110707\\_Outourcing\\_SpringfieldContract0014\\_06.PDF](http://www.pioneerinstitute.org/pdf/110707_Outourcing_SpringfieldContract0014_06.PDF)

Sample invitation to bid for custodial services contract:

[http://www.pioneerinstitute.org/pdf/110707\\_Outourcing\\_SpringfieldCustodialService\\_06.PDF](http://www.pioneerinstitute.org/pdf/110707_Outourcing_SpringfieldCustodialService_06.PDF)







