

## **Contract Management and its Impact on Contracting Public Services: Slovak Republic<sup>1</sup>**

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### **Abstract**

*Contracting out is the prevalent types of alternative service-delivery arrangements in public sector. The literature suggests that if the contracting is properly implemented, then it will improve cost-effectiveness, delivery quality, and expenditure control. Using new Slovak data, we explain why contracting does not always produce the expected positive results. We seek to determine the factors that account for success in contracting for public sector services, by testing for a link between contracting performance and quality of contract management. This study uses a quantitative approach to analyse our original survey data. The findings are not positive, because although competitive selection is the key factor determining success, non-competitive selection of suppliers prevails in Slovakia.*

**Keywords:** *contracting, public sector, principal, agent, contract management, Slovak Republic*

**JEL Classification:** H41, H57

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### **1. Introduction**

Contracting out public services to private for-profit and non-profit firms is one of the most common types of alternative service-delivery arrangements. The relevant literature suggests that if, and only if the contracting is properly implemented, then it may, but need not improve individual choice, cost-effectiveness, delivery quality, equity, and expenditure control.

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This article uses Slovak data to explore why contracting does not produce the expected results and may even have perverse effects. We start with a brief summary of current knowledge about contracting in Slovakia.

At the core of our paper is an attempt to determine the factors that account for success in contracting for services in the public sector. This involves testing for a link between contracting performance and selected factors connected with contract management; such as competition, evaluation of bidders, contract monitoring, contract payment and sanctions. The key importance of the study is its originality in both Slovak and regional perspectives. We use a quantitative approach to investigate the research question and analyse original survey data generated by our own research undertaken in the Slovak Republic.

## **2. Contracting in Slovakia: A Brief Survey**

There is a substantial body of published research about contracting in Slovakia. We may list our studies (see Meričková, Nemec and Vítek, 2005; Meričková and Nemec, 2007; Meričková, Nemec and Ochrana, 2008; Meričková, Nemec and Šumpíková, 2010; Meričková et al., 2010) and the findings of other authors (especially Balážová, 2006; Čapková, 2010; Majlingová and Šagát, 2006; Pavel, 2007; Sičáková-Beblavá and Beblavý, 2007; Sičáková-Beblavá, 2009; Sičáková-Beblavá and Beblavý, 2009; Vozárová, 2012). The key common finding of these studies is that in Slovakia contracting has not delivered the expected results.

Below we summarise comparative data on the frequency of contracting (Table 1), and the efficiency of contracting (Table 2), for five important local services; maintenance of local communications, maintenance of public lighting infrastructure, management of cemeteries, waste collection and waste disposal and management of public parks and green areas. The following samples are used:

1. Our representative sample of 55 Slovak municipalities, of varying sizes, from 2001.
2. Our representative sample of 17 Slovak municipalities, of the same size, from 2005.
3. Data gathered by the 2006 research project (including our team) of Transparency International Slovakia; focusing on the relationship between the local public service delivery arrangements and the cost efficiency of service delivery. The sample covered 100 Slovak municipalities.
4. Our non-representative sample of 28 Slovak municipalities, of varying sizes, from 2008.
5. Our representative sample of 131 Slovak municipalities, of varying sizes, from 2009. Later in the paper this sample is used for our analysis of factors determining the success of contracting.

6. Our representative sample of 141 Slovak municipalities, of varying sizes, from 2010.

Table 1

**Percentage of Contracted Local Public Services**

Service	2001	2005	2006	2008	2009	2010
Waste	49	64	69	80	69	80
Cemeteries	27	12	16	13	29	50
Public green areas	16	18	33	14	21	49
Communications	21	41	45	38	36	52
Public lighting	30	35	40	39	50	35

Source: The six studies cited above.

Table 2

**Efficiency of Contracting Out Local Public Services**

Service	2001	2005	2006	2008	2009	2010
Waste management	94	94	125	184	100	138
Cemeteries	64	13	67	146	87	84
Public green	82	192	150	151	120	97
Maintenance of local communications	70	109	119	114	100	84
Maintenance of local lighting	100	138	128	156	104	103

Note: Efficiency is measured as the cost of outsourced services to the cost of internal delivery, expressed as an index number.

Source: The six studies cited above.

The data clearly shows that contracting out of local public services is very common in Slovakia. The results from contracting are contradictory, and there are several methodological problems, of which we are fully aware. The core problem is the reliability and complexity of the data provided by municipalities. In fact there is no full cost accounting at the local self-government level, and this devalues the cost data on internal service delivery. Some of the selected municipalities also use a mix of internal and external production for service delivery – in such cases we asked for data about the dominant delivery form.

Our own primary research indicates that contracting of public services in Slovakia delivers less positive outcomes than the existing literature suggests are attainable. To help explain why, we now focus on evaluating contract-management factors. For Slovakia this is a unique original analysis.

### **3. Contract Management Quality and its Impact on the Efficiency of Contracting out**

The absence of systemic contract management is one of the core reasons for contracting failures (Hodge, 2000; Sclar, 2000; Brudney et al., 2005; Kamerman and Kahn, 1989; Stejskal and Charbusky, 2004; Štrangfeldová and Hronec, 2008).

The literature suggests that the following factors determine the quality of contract management: the degree of competition in bidding for the contract (Savas, 1987; Kettl, 1993; Greene, 2002; Hodge, 2000; Pavel and Beblavá, 2008); the quality of the ex-ante evaluation of the contractor/agent (Rehfuss, 1989; Marlin, 1984; Romzek and Johnston, 2002); a clear definition of the contracted/outsourced service – contract specification (Rehfuss, 1989; Marlin, 1984); the quality of contract monitoring (Rehfuss, 1989; Marlin, 1984; Prager, 1994; Seidenstat, 1999; Brown and Potoski, 2003a; Hefetz and Warner, 2004; Šebová, 2007); sanctions (DeHoog, 1990; MacNeil, 1978); the experience of the public body/government/principal responsible for contracting/outsourcing with contract management (DeHoog, 1990; Rehfuss, 1989; Romzek and Johnston, 2002); and the technical knowledge of the contracted service (Kettl, 1993).

More recent approaches to contracting argue that relational contracting is a more flexible and cooperative approach to managing contractual relationships based on mutual trust, shared norms and values, and standards of behaviour. Such approaches also treat communication and joint problem solving between principal and agent as determinants of contracting performance (DeHoog, 1990; Sclar, 2000; MacNeil, 1978; Fantová Šumpíková, and Rousek, 2009; Vaňová, 1996).

#### **4. Research Methodology and Results: Quality of Contract Management**

Given this theoretical background, our application of the Delphi method (Vozarova, 2012) suggested that the following five factors might influence the quality of contract management.

- $x_1$  – level of competitiveness of the award
- $x_2$  – selection criteria
- $x_3$  – frequency of contract monitoring
- $x_4$  – sanctions
- $x_5$  – method of payment to supplier/agent.

All five factors have a qualitative character. Table 3 shows how we transformed them into quantitative data.

The analysis uses primary data from our 2009 research on a representative sample of 131 Slovak municipalities of varying sizes (see Tables 1 and 2).

The findings are set out in Table 4 and are not very positive. The average contract management score is about 60 (out of 100). Better results are normally received for soft indicators, where evaluation is based on the subjective opinion/response from the staff involved.

**T a b l e 3**  
**Conversion to Quantitative Data**

Factor	Description	Points
$X_1$ – Level of competitiveness of the award	Open tender Restricted procedure Negotiated procedure Price quotation Direct award	100 70 50 30 0
$X_2$ – Selection criteria	Best bid Lowest price	100 50
$X_3$ – Frequency of monitoring	Regular Irregular No monitoring	100 50 0
$X_4$ – Contract sanctions	Cancellation of the contract Financial sanctions Right to request improvements Other	100 70 30 0
$X_5$ – Method of payment to supplier	Performance payment Mixed performance and lump-sum payment Lump-sum payment	100 50 0

*Source:* Own research.

**T a b l e 4**  
**Quality of Contract Management for Contracting Local Public Services**

Service	Competitiveness	Ex-ante evaluation	Monitoring	Sanctions	Payment conditions
Waste	42.84	67.12	70.32	42.08	65.65
Public lighting	47.11	72.73	65.26	45.20	63.72
Local communications	50.12	64.40	64.13	43.50	74.15
Public green	58.89	66.39	54.72	46.81	75.90
Cemeteries	29.43	68.27	64.29	45.18	45.79
Average	45.68	67.78	63.74	44.55	65.04

*Source:* Own research.

## **5. Research Methodology and Research Results: Factors Determining the Success of Contract Management**

The theoretical background described above suggests that there should be some relationship between the quality of contract management and the contracting performance. We tested the existence of this relationship for Slovakia by calculating Spearman's correlation coefficient, where the dependent variable is the efficiency of contracting (Table 2, 2009 data) and the independent variables are the factors determining the contracting efficiency ( $x_1 - x_5$ ). The assumed null and alternative hypotheses were:

$$H_0 : \rho_s = 0 \text{ (no statistically significant correlation)}$$

$$H_1 : \rho_s \neq 0 \text{ (statistically significant correlation exists)} \quad (1)$$

$$\text{The level of significance for the hypothesis test was } \alpha = 0.1 \quad (2)$$

With SPSS Data Editor we calculated the value sig. (2-tailed) for statistically significant correlations between the dependent and independent variables (Table 6). If there is statistically significant correlation Sig. (2-tailed) <  $\alpha$  we will reject the null hypothesis. In such a situation we calculate the Spearman's rank correlation coefficient  $p$  as a nonparametric measure of statistical dependence between contracting out efficiency and the factors related to contract management ( $x_1 - x_5$ ):

$$\rho = 1 - \frac{6 \sum_i (p_i - q_i)^2}{n(n^2 - 1)} \quad (3)$$

We interpret the results as:

- $p$  value is close to  $-1$ : negative correlation,
- $p$  value is close to  $1$ : positive correlation

Table 5 shows the values of Spearman's rank correlation coefficient  $p$  for these factors related to contract management, where the values Sig. (2-tailed) is less the  $\alpha$ : that is factors for which the hypothesis H1 is confirmed.

**T a b l e 5**  
**Correlations for Contracting Local Services**

Service	Contract management factor	Sig. (2-tailed) value	Spearman's rank correlation coefficient	Correlation
Waste	$x_1$ – Level of competitiveness of the award	0.000	0.333	Positive
	$x_3$ – Frequency of monitoring	0.031	0.209	Positive
Public lighting	$x_1$ – Level of competitiveness of the award	0.000	0.579	Positive
Local communications	$x_1$ – Level of competitiveness of the award	0.000	0.666	Positive
Public green	$x_1$ – Level of competitiveness of the award	0.000	0.804	Positive
	$x_5$ – Method of payment to supplier	0.083	0.361	Positive
Cemeteries	$x_1$ – Level of competitiveness of the award	0.001	0.731	Positive

*Source:* Own research.

Similarly to other studies, we found that the frequency of monitoring of the services and the method of payment to the supplier are positively significantly correlated with contracting efficiency. The data clearly indicate that the level of competitiveness of the award is the key contract management factor influencing the efficiency of contracting.

This outcome fully supports assumptions that contracting is expected to produce major efficiency gains because of competition in the service delivery market. But all the Slovak studies already noted above indicate that this potential is insufficiently exploited, for two key reasons. First, in many areas there are few potential private suppliers. Second, even though competitive selection is mandated by the procurement law, it often does not happen. The data we collected on the modes of awarding contracts confirms this result (Table 6). If such poor practices continue in Slovakia, then contracting of public services will not deliver positive results. But as Beblavý and Sičáková-Beblavá (2006) state, there are also important inefficiencies with in-house production.

**Table 6**  
**Methods of Selecting External Suppliers (%)**

Procurement method used	2001	2005	2006	2008	2009
Open procedure	16	17	27	32	17
Restricted procedure	5	0	5	3	14
Negotiated procedure	0	13	30	0	7
Price bid	0	0	0	25	4
Direct purchase	31	17	38	30	11
Municipality was not willing to provide information	48	55	–	25	66

*Source:* The six studies cited above.

## Conclusions

The theory of contracting suggests that it has the potential to improve efficiency, given certain conditions. Because several socio-economic preconditions for successful contracting are at present insufficiently developed in Slovakia, contracting delivers less positive outcomes than might be expected.

Contracting out is a very common solution in municipal practice: for example dominating the delivery of waste management services. But its efficiency is limited, and internal production seems to deliver better results.

The core part of our paper tests the above conjectures using Slovak data. We measure the impact of qualitative contract management factors, selected by the Delphi method, on determining contracting efficiency. The results indicate that there are several important factors limiting success, by far the most important being the degree of competition for the contract. Too few contracts involve a competitive bidding process between would-be suppliers. Our data covers more than a decade, and it is clear that this problem is not improving. To change this situation accountability needs to become a real value in our public-administration systems, and intervention has to focus not only on processes but also on results.

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