



BEST PRACTICE

Managed Competition as a Service Delivery Option (2006) (BUDGET)

Background. Governments are continually tasked with providing high quality services within the constraints of limited financial resources. In order to meet this challenge, many governments have turned to the private sector or other governments as an alternative to in-house service delivery as potential ways to save money or improve services. One choice within potential service delivery options is managed competition, in which governments require in-house service units to compete with external providers.

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments systematically identify and evaluate the major factors in considering a managed competition option. Service level, cost, efficiency, effectiveness, quality, customer service, and the ability to monitor the service provider's work should be essential components of any managed competition decision. In addition, governments should clearly define the service parameters in the expected service delivery.

When evaluating whether to undertake a managed competition initiative, governments should consider the following key points:

- 1. Executive Direction.* The heads of government must support a move toward a managed competition service delivery model. Support from the government's executive and legislative leadership is essential. The governmental leaders should establish clear expectations and standards for such an initiative. It is necessary to have a transparent process.
- 2. Environmental Consideration.* Consideration must be given to how managed competition is affected by demographics, the economy, geography, citizen sensitivity and the local political environment. Organizations are encouraged to closely evaluate the strengths and weaknesses of the jurisdiction relative to the managed competition option. Consideration should also be given to an analysis of opportunities and threats on the environment external to the organization. A look at how other communities have fared with managed competition for that particular service may be necessary.
- 3. Stakeholders' Support.* Stakeholders need to be appropriately involved. Stakeholder groups may include unions, employees, media, advocacy groups, local businesses, and the public. By involving stakeholders in the managed competition process, governments will have a better opportunity to convince stakeholders of the value of a competitive service model.
- 4. Legal Ramifications.* Issues associated with employment law compliance and existing labor agreements must be considered. If a switch to managed competition affects union employees, options like workshops, meetings, and open forums should be considered to communicate to labor unions the possible benefits of managed competition. Human resource impacts should be a factor when making the determination whether to go ahead with managed competition. As part of the negotiations with potential contractors, thought should be given to hiring the current workforce or retraining current employees for reassignment. It should be noted that shifting a service to a contractor might transfer liability and other risks to the contractor (even though these risks are likely built into the contract price).

5. *Service Availability.* The services considered for managed competition should be measured against the availability of the service in the market place. Some services, such as trash collection and building construction, may lend themselves to competition. Fairness of competition should also be analyzed. In addition, consideration should be given to the total investment that the government has made in the current service delivery. A substantial prior investment may preclude the government from entering into a competitive situation.

6. *Cost.* The cost decision as to whether to perform a service “in house” or outsource it to an external provider involves four basic steps. Determining the different cost structures is necessary before proceeding with the request for proposal (RFP). However, cost should not be the only basis in comparing competitive bids. Governments should develop a decision-making process that seeks to account for all relevant factors.

- *Service definition.* The first step in a cost analysis is to clearly define the government service that is being considered for outsourcing. A thorough analysis of the service level and performance standards will provide the best framework for evaluating the full cost of the service, whether it continues to be delivered in-house or it is outsourced to an external provider.
- *Calculate the in-house costs that could be avoided by outsourcing the service.* GFOA’s Best Practice, *Measuring the Cost of Government Services*, defines the full cost of a service, as that which encompasses all direct and indirect costs related to that service. Governments should understand that not all indirect costs would be avoided if the service were outsourced.
- *Estimate the total costs of outsourcing.* The costs of outsourcing include the contractor’s bid price, the government’s contract administration costs, and the government’s transition costs, less any new revenue generated from outsourcing.
- *Compare the cost savings from outsourcing to the costs incurred.* The final step in a make-versus-buy cost analysis is to calculate the difference between the costs saved by outsourcing a service and the costs incurred. If the costs saved are significantly greater than the costs incurred, then outsourcing may make financial sense.

7. *Transition Process.* Governments must be fully prepared to allow for a smooth transition if a change in a service delivery provider takes place. It is essential that initial monitoring occur to make sure that no disruption in service arises.

8. *Performance Metrics.* Governments must employ performance metrics as a means of comparing and evaluating efficiency and effectiveness standards for service activities. Elements like productivity, quality, timeliness, and desired outcomes are needed. Contract staff must be prepared to develop and manage a competitive services agreement. The success of competitive service delivery often rests on the ability of the organization to develop and manage a strong performance based services agreement (including appropriate incentives and penalties). It is imperative that an organization develops the skills to design relevant performance metrics that ensure service quality. The establishment of consistent benchmarks that measure service performance is essential.

References

- GFOA Best Practice, “Performance Management: Using Performance Measurement for Decision Making, 2002 - Updated Performance Measures,” 1994.
- GFOA Best Practice, “Measuring the Cost of Government Services,” 2002.
- “Make or Buy? Using Cost Analysis to Decide Whether to Outsource Public Services,” *Government Finance Review*, August 2004.
- GFOA Best Practice, “Establishment of Strategic Plans,” 2005.

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