

Chapter 10

(The Difficult Art of) Outsourcing Welfare Services: Experiences from Sweden and New Zealand

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Introduction

A main enduring element of New Public Management-type reforms seems to be a new division of labour between the state and other societal sectors, notably the market and civil society. This was reflected in a report from the OECD (OECD 2005) that summarized the ongoing modernization of the public sector. One of the five areas covered in the report was ‘The Use of Market-type Mechanisms to Provide Government Services’. The report divided these market-type mechanisms into three categories: outsourcing, public–private partnerships (PPPs) and vouchers.

Outsourcing is defined as ‘the practice whereby governments contract with private sector providers for the provision of services ...’ (OECD 2005, 131). The term ‘outsourcing’ originates from the private sector, where it used to describe operations that were performed ‘in-house’ but then were split off and contracted out to an external provider. Later the term outsourcing has become almost synonymous with purchasing/procurement. Generally speaking, however, outsourcing or contracting out refers to the provision of a service over an extended period of time, such as a road-construction project or the daily provision of cleaning services for office buildings, rather than the one-off purchasing of products. During the NPM era outsourcing or contracting out to an increasing degree has been subject to compulsory competitive tendering (CCT), where the service in question is advertised and contractors are invited to submit bids. The bids are then evaluated before a contractor is finally chosen.

Outsourced services can take many forms, from fairly simple support services like cleaning, waste management or ‘back office’ services like IT-maintenance, to what are often considered core public operations, such as rescue and fire services, the running of prisons or food inspection. But even in such fields as health care, education and other welfare services, outsourcing has increased considerably (OECD 2005, 134).

Public–private partnerships (PPPs) refer to ‘arrangements whereby the private sector finances, designs, builds, maintains, and operates infrastructure assets traditionally provided by the public sector. (...) Public–private partnerships bring a single private sector entity to undertake to provide public infrastructure assets for

their “whole of life”, generally 20–30 years. (...) The private sector partner then charges an annual fee for the use of the infrastructure assets. This can either be paid by the government or through user charges, or a combination of the two’ (OECD 2005, 131). Most OECD countries have used PPPs sparsely. The most extensive user is the United Kingdom, where around 10 per cent of investments in the public sector were made according to the PPP model in 2003–2004 (OECD 2005, 141).

Finally, *vouchers* ‘separate the provision of public services from its financing. The funding remains with the government in the form of a voucher that is issued to individuals and which entitles them to exchange the vouchers for services at a range of suppliers. The individual voucher-holder chooses among the different suppliers and pays with the voucher’ (OECD 2005, 131–2). Vouchers are most often discussed in relation to primary and secondary education, where the Netherlands and Belgium stand out as the most extensive users. There, more than half of the funding for primary and secondary education goes to private schools. In the UK and Australia the figure is around 20 per cent, while in Norway, New Zealand and Sweden the figure is less than 5 per cent (OECD 2005, 149). Vouchers are also used in the field of child care, where Australia, according to the OECD, has introduced the most comprehensive reforms (OECD 2005, 148), and extensively for the care of the elderly. In the USA, Australia, the UK, Germany and New Zealand around 80 per cent or more of beds in institutions (for the elderly) are private. The Nordic countries here stand out as being most ‘public’, with around 85–90 per cent of beds in elderly homes being public (OECD 2005, 150).

Among the three forms of market mechanisms mentioned above, outsourcing is by far the most important. According to OECD calculations, the United Kingdom has the highest level of outsourcing among the Western OECD countries. According to the OECD, almost 80 per cent of government services are outsourced in the UK. The USA comes next, with almost 65 per cent. Norway, Switzerland, Sweden, New Zealand and Australia have an outsourcing rate of around 50–60 per cent. The lowest rate of outsourcing is to be found in European countries like Spain, France and Italy (around 25 per cent) and Portugal (less than 20 per cent) (OECD 2005, 133).

Like in many other OECD countries the degree of outsourcing in Sweden is not only high, but it also seems to be increasing (ESV 2006, 18). The main argument for outsourcing has been to lower costs, and there seems to be a general understanding that outsourcing, at least initially, has lowered direct costs for a certain operation (Svensson and Edebalk 2001). There is less agreement on the effects in a longer perspective, and some authors claim that outsourcing might have a negative effect on costs in a broader sense (Sundin 2006).

In this volume the issue of public–private partnerships is dealt with in Chapter 9, so in this chapter the discussion will be restricted mainly to the question of outsourcing and to examining some of the critical issues involved. Outsourcing/contracting is not per se a generic part of the New Public Management wave of reforms. States, on national, regional and local levels, have always purchased services and goods from external providers. What is new is the extent of outsourcing, and also that outsourcing now takes place in areas where the welfare states for a long time have been, if not the sole, then the key providers. What is new is also the much more formalized procedures of outsourcing, which to a large degree is based on economic

theoretical thinking. In this sense an old practice has been transformed during the NPM era and, since outsourcing is a difficult art, as we will show, our prediction is that it will continue to transform (see Chapter 1 in this volume for a discussion on the transformative approach).

Some of the points made in this chapter are quite generally applicable to all types of services outsourced, but here the focus is on welfare services, like health care, social care and education, which contain a strong element of direct face-to-face contact between provider and consumer/customer.

The discussion on outsourcing is based mainly on data from Sweden and, to some extent, from New Zealand. These countries both have a high level of outsourcing. However, while in Sweden most contracting out of welfare services goes to profit-oriented business firms, in New Zealand non-profit voluntary organizations play an important role (Ministry of Social Policy 2001; Cribb 2006). Sweden also has a large civil society sector but mainly in areas other than the provision of welfare services (Wijkström and Lundström 2002). For these services the state and local and regional governments have for a long time been almost the sole providers.

The starting point for our discussion is the conclusion drawn by Donahue in his review of 'privatization' attempts in the USA (Donahue 1989). In this review Donahue summarized experience with procuring services (and products) as diverse as defence (which, according to the definitions used in this chapter, would be classified as public-private partnership or purchasing of products), job-training, prison services and local services like rubbish collection, ambulance services and street cleaning. Leaning heavily on transaction cost thinking, Donahue came to the following conclusion about successful contracting out of public services:

The more precisely a task can be specified in advance and its performance evaluated after the fact, the more certainly contractors can be made to compete; the more readily disappointing contractors can be replaced (or otherwise penalized); and the more narrowly government cares about ends to the exclusion of means, the stronger becomes the case for employing profit-seekers rather than civil servants. (Donahue 1989, 79–80)

In short, Donahue emphasized: 1) the importance of specifying the task being contracted out in terms of ends (outputs/outcomes); and 2) the importance of competition among providers (in order to give the contractor the opportunity to replace an unsatisfactory provider) in order for the contracting out of any public service to be successful. In this chapter we will focus mainly on the first part of Donahue's conclusion, only briefly touching on the second part.

A Transactional or Relational Approach to Purchasing

The business sector has a long history of purchasing and outsourcing and we think it is appropriate to connect to experiences of outsourcing/purchasing in that sector. A fundamental question that arises when we discuss industrial purchasing is the make-or-buy choice, in other words, the question of whether one should produce a particular product or service oneself or buy it from a supplier (Gadde and Håkansson 1993). If a decision was taken to buy, traditionally the main task for the purchaser

in an industrial market was to buy the right product at the lowest possible price. This meant that purchasers would shop around among suppliers for the best price. This approach to purchasing was supported theoretically by neo-classical economic micro-theory. According to this theory, perfect markets mainly serve as price-setting mechanisms, where the price depends on the levels of supply and demand.

This view of purchasing was challenged in the late 1970s, when the European IMP project (industrial marketing and purchasing) was carried out. From data collected in five European countries, it became obvious that most companies did not regularly shop around among suppliers but instead had a limited number of strong business relationships with important suppliers and customers (Håkansson 1982; Ford 1990).

Furlong et al. (1994) called these two approaches to purchasing the competitive or adversarial model versus the negotiation or partnership sourcing model. In a later paper Lian and Laing called the two modes of purchasing the *transactional* and the *relational* paradigms, respectively (Lian and Laing 2004, 248), and it is these terms that we will employ here.

Using a *transaction approach* means keeping suppliers at arm's length, treating transactions as single, one-off events. This approach used to be considered advantageous for several reasons. The main argument was flexibility. This held that with no strings attached it was easier to change supplier whenever a supplier offering a better price was found (Gadde and Håkansson 1993). A transaction approach entails using a detailed contract in order to ensure that the product delivered is up to standard, since amendments are difficult to introduce in retrospect. Detailed contracts and monitoring are also needed in order to avoid opportunistic behaviour by the supplier.

By using a more co-operative, *relational approach* towards suppliers a purchaser can avoid some of the disadvantages of the transaction approach but still keep some of the advantages of the make-it-yourself option: first and foremost, control (Gadde and Håkansson 1993). In a relational approach transactions are never seen as single events, but rather as part of a long series of transactions. Both parties invest in the relationship and become dependent on each other. This does not necessarily mean that the relationship is always friendly or conflict-free, but it means that opportunistic behaviour from either side will be costly for both. By using a relational approach towards a supplier, a purchasing partner can apply the same incremental, ongoing specifications as it does when it decides to produce its own products or services. Detailed contracts can be dispensed with, and flexibility is preserved, but in a different way to the transaction approach. Here, flexibility means not the freedom to switch supplier(s), but rather a flexible approach to specification, contracting and monitoring, while the benefits of an efficient social division of labour – that is, letting better and more specialized partners do the production – is still preserved.

In a transaction approach the focus is on the *price* and the aim is to lower the price. In a relational approach the focus is on the *total costs* including quality aspects, rather than just on the price, which is considered to be only one, often minor, element of total costs. Hence, if the aim is to lower indirect costs, co-operation with the supplier seems to be a better strategy than playing one supplier off against another (Gadde and Håkansson 1993).

When states, in the wake of NPM reforms, decided to outsource various kinds of services, they tended to apply a transaction approach. According to Lian and Laing (2004), both the European Union and the United Kingdom embraced the transactional approach (or paradigm, as they call it). This is obviously also the case in New Zealand (Cribb 2006) and, as we shall see, in Sweden. Now, let us take a closer look at the Swedish example before we turn to New Zealand.

Experiences from the Field I: Sweden

At the beginning of the 1990s, the Swedish Parliament passed the Public Procurement Act (PPA) (SFS 1992, 1528). A new trade agreement between Sweden and the common market was the main argument in favour of the new legislation. For the government, the PPA was a means to enhance efficiency in public-sector service provision. Accordingly, the PPA is now used by politicians and civil servants in state agencies, counties and local governments, and its use is compulsory when any public unit decides to purchase products or services from external providers.

The first paragraph of the PPA stipulates that public procurement should be carried out using business principles. One interpretation of those principles is that purchasing should involve competition; another is that competing providers should be treated without using any irrelevant considerations. The act stipulates that:

A purchasing unit should choose either the tender that is the most advantageous in economic terms or the tender that has the lowest price. When the principle of the most economically advantageous tender is applied, the purchasing unit should take into consideration all circumstances like price, time of delivery, cost of operations, quality, aesthetics, functional and technical features, service, technical support, environmental effects, and so on.' (SFS 1992, 1528:6, our translation).

The other condition associated with the business principle is that suppliers should be treated without any irrelevant considerations. Civil servants should evaluate tenders in an objective way and no supplier should be favoured.

We view these two principles as interpretations of certain well-known market ideas. First, it is obvious that the drafters of the PPA were influenced by neo-classical economic micro-theory – the market as a price-mechanism. Secondly, they also seem to have been influenced by ideas on market frictions, like transaction costs (Coase 1937), and by ideas from the academic discipline of marketing concerning the differentiation of products (for example, according to quality).

According to the provisions of the PPA, the procurement process is divided into two phases. In the first phase, the procurement is presented in a written formal procurement document. Once the document has become official, it must be followed and the content cannot be changed. This document is sent to all interested providers, who are then requested to send a tender to the purchasing agency. In the second phase, civil servants evaluate the tenders and decide which provider(s) to contract.

However, the procurement process is also regulated in other types of legislation in a more implicit way. For instance, the Social Care Act (SFS 1982) and the School Act (SFS 1985) regulate services provided by local governments to citizens. The

two Acts contain a large number of provisions that could potentially be applied to the provision of a certain service. We consider some of these provisions to be of particular interest. One trend of the 1990s that was reflected in the legislation was a new focus on the citizen. Various paragraphs in the legislation stipulated that the service provided should be adapted to the requirements of the citizen. A second trend in the 1990s was that of quality assurance, and this, too, was enshrined in administrative legislation. A third trend during the 1990s was to de-emphasize the role of professional groups in service provision. Administrative legislation sometimes stipulated that the providers of services should employ personnel with an appropriate education rather than personnel from a certain type of profession.

The Interpretation of the PPA in Local Welfare Markets

Swedish local governments are more autonomous than local governments in most other European countries (Pollitt and Bouckaert 2004). The local government sector also constitutes a larger part of the public sector than in most other European countries, and most of the welfare services are provided and financed by local governments and county councils (Forssell 2002). Thus, the local governments play an important role in the construction of welfare markets. Local governments can, for instance, decide for themselves whether an operation should be put up for tender or not and how the tendering process should be carried out.

In order to find out how the principles of the PPA are applied at local government level, we studied one case of public procurement in the medium-sized town of Uppsala (population 180,000). The operation subjected to public procurement concerned GV, a home for the elderly where the residents needed a great deal of care and nursing. It was managed by a district council, and the premises, which were new, were owned by the local government.

In 2000 the district council decided to make GV subject to a public tendering process in line with the PPA. This decision followed a decision by the city council to make 30 per cent of all homes for the elderly subject to competition. (In the spring of 2002 about 15 per cent – six or seven homes – were procured after public tenders.)

In 1987 the city of Uppsala was divided into 14 administrative districts that were in charge of services like schools, pre-schools, social services, homes for the elderly and home services for the elderly and disabled. Later a purchaser–provider model replaced the district model.¹ One element of the new model was the creation of a procurement unit with a staff of around 20 people. This unit was given the task of preparing the procurement document in this case and one officer was assigned to this job. A couple of other people were also involved in the preparation, among them a nurse who worked in the unit of medically responsible nurses and an officer from the Uppsala purchasing department. The procurement of the GV elderly home was advertised in several papers and also in the Tender Journal, and the deadline for tenders to be submitted was 8 February 2001.

1 From 1 January 2003 the district model was abolished and instead the city organization was structured according to a few main functions combined with a general purchaser–provider model.

We will now briefly describe the procurement document and then go into somewhat more detail on how the tenders were evaluated. The descriptions are based on interviews with people involved in the process.

The Procurement Document

This particular procurement document concerned two homes for the elderly: one was the GV elderly home and the other was situated in another district. Would-be providers could submit tenders for either one or both of the homes. The procurement document was based on a template taken from the Swedish Association of Local Authorities, to which more specific information and specifications were added. In all, the document encompassed 24 pages divided into four main sections. Interestingly, most of the paragraphs concerned both homes; only a few paragraphs related to only one of them. We shall not give an extensive summary of this document but will focus on just a few paragraphs. The first of these stated how the tenders were to be evaluated, saying:

The most advantageous tender from a total economic point of view will be chosen on the basis of the following criteria, given in order of preference :

1. Programme declaration
2. Price

Since the 'Programme declaration' was of crucial importance for the evaluation of the tenders, we will list the criteria mentioned there. The 'Programme declaration' was part of the second section of the document – the 'Prescription for procurement' section. The criteria listed were:

- General purpose and direction of operations
- The organization of care of the elderly according to the SoL (Social Services Act, our comment), including rehabilitation and nursing
- Documentation according to SoL and HSL (Health Act, our comment)
- How a meaningful daily life for residents should be achieved
- Handling of meals and diets
- Residents' and relatives' channels for influence, including the handling of complaints
- Co-operation with voluntary organizations
- Management
- Staffing and time schedules
- Personnel competence and development

It is worth noting that the procurement document *did not* constitute a detailed specification of the operation that was subject to the tender process. This list of criteria should rather be seen as a checklist to be used by providers to specify their particular concept of how to operate this home for the elderly. In other words, it was

the would-be providers that specified the services and not the contracting authority. They did so by submitting more or less explicit and detailed tenders in writing, which could be used for evaluation.

The Evaluation of Tenders

By 9 February 2001 the purchasing department had received five tenders. Among them was one from an internal provider, namely the district unit currently operating the GV home. The other four were from privately owned companies.

The first step in the evaluation process was for the purchasing department to check to see whether the would-be providers were qualified to take part in the procurement process. This check followed routines stated in the procurement document and concerned, among other things, whether the tenders were complete, whether the providers were economically sound and whether they had the capacity to run the home. The next step was to remove the prices from the tenders, so that no-one apart from a few people in the purchasing department would know what prices the providers were offering.

Now the evaluation of the tenders, that is, the qualitative parts of them, could take place. In a first round three persons were involved, one from the unit of medically responsible nurses and two from the procurement unit, one of whom was the person who had been responsible for writing the procurement document. All three of them read all the tenders and then met to make an evaluation. At this meeting an important role was played by the evaluation form.

The Evaluation Form

For the evaluation a form following the criteria stated in the procurement document was used. This was a standard form but was slightly adapted to comply with the criteria used in this specific case.

The evaluation group's task at this stage was to grade all tenders according to the criteria stated in the procurement document on a scale from 1 to 5, where 1 point = inadequate description, 2 points = quality or competence deficiencies, 3 points = low quality, 4 points = average quality and 5 points = high quality. The criteria were not considered to be equally important, though, so they were weighted according to a percentage scale. The second criterion ('the organization of care of the elderly ...') was given the greatest weight, 25 per cent, while the seventh criterion ('co-operation with voluntary organizations') was given the lowest, 2.5 per cent.

All tenders were given one column each and then were graded according to each criterion. After that had been done, all the grades were multiplied by their weightings, then the weighted grades were added up for each of the tenders. By comparing the resulting figures, a ranked list of the tenders could be obtained. However, this preliminary evaluation took into account only the qualitative criteria. The next thing to look at was the price.

This phase of the evaluation was carried out by the procurement unit and the purchasing department. Only the purchasing department knew the prices of the different tenders, and they could now add them to the form. Now, another calculation

took place where the tenders were ranked according to price from the lowest price down to the highest.

However, to conclude the evaluation, the qualitative points and price points needed to be combined. Since the procurement document stated that the qualitative assessment was more important than the price offered ('these criteria are given in preferential order: 1) Programme declaration and 2) Price'), the question now was to decide exactly how much more important the programme declaration was. In the past this had varied. Often the qualitative criteria were given a weighting of 51 per cent, but this time the district council had decided beforehand that the programme declaration should be given a weighting of 55 per cent and the price 45 per cent. By making this final adjustment and then adding the weighted qualitative and price points ('prioritet 1' and 'prioritet 2' on the form), the purchasing department was able to select a winning bid.

Back to the Evaluation Process

The grading of the tenders according to the qualitative criteria (done by the three people mentioned above) took approximately one day. According to the participants the discussion was lively and assessments of the tenders differed, but eventually the three were able to reach a unanimous decision. When the grading had been done, the results were presented to some members of the district council, and together these two groups, the officials and the politicians, invited some of the would-be providers to come for an interview. A representative from the purchasing department was also involved in deciding who to call for interview. This is an important point, since the purchasing department was the only actor who knew the prices of all the tenders and could thus identify any tender that had a high price but scored only low to medium regarding quality. Tenders of this kind were eliminated from the contest at this stage.

In this particular case, the procurement of the GV home, the two bidders that had scored highest on the quality criteria and the one that was ranked third, but had the lowest price, were called to a meeting with the group of evaluators. This group consisted of about ten people, including both officials and politicians. During these interviews the evaluators asked for further specification and clarification, and the providers had a chance to elaborate on their tenders.

In this case the interviews did not change the preliminary grading. The winner of the evaluation process was the fifth tender, which turned out to be the local district unit that was currently operating the GV home for the elderly. Although the tender did not have the lowest price, it scored highest on the qualitative criteria and on total points. We might add that the evaluation process pertaining to the other home, which was subject to procurement at the same time and which was presented in the same procurement document as the GV home, was won by one of the private providing companies.

Conclusions from the Swedish Case: Applying a Transaction Approach in Practice

From this case it is clear that a tendering process of this kind is far from ideal when applying a transaction approach. In the ideal situation the services in question would be clearly specified by the purchaser, the would-be contractors would present their prices, and the contractor with the lowest price would win.

Instead of a straightforward process of this sort, here both the purchaser and the contractors had to go through an arduous process of first trying to reach an approximate understanding of 1) what the purchaser wanted, and 2) what the contractor intended to deliver, followed by a 'beauty contest' in which the purchaser tried to evaluate and choose among the tenders. One might think that the case presented above is an exception, but procedures like these in fact seem to be rather a common model for purchasing of many different services, from care of the elderly to safety systems for airports. As Bitner (1995) and Grönroos (1998) have observed, the marketing of services is really about promises. And purchasing processes of the sort discussed verify that what the contractors presented in their tenders were promises, and what the purchasers did when evaluating tenders was to choose among promises.

Interestingly enough, the local government of Uppsala, in June 2004, decided to use a fixed price in all outsourcing of elderly care from that date on, thus letting all would-be providers compete only on the basis of their promises in regards to certain qualitative criteria (Uppsala 2004). In this way the 'beauty contest'-character of outsourcing became even more emphasized than before.

Obviously purchasing processes of this kind bring about some transaction costs (one could even view this kind of process as consisting of transaction costs only). In that sense our observations are in line with others who have observed or warned about an increase in bureaucracy and administrative work when outsourcing (Farrell and Morris 2003; Hallin and Siverbo 2003). Still, calculations of transaction costs in the outsourcing of elderly homes in Sweden show that they are fairly low, about 1–5 per cent of total cost (Johansson 2004).

Standardizing and Bureaucratizing the Outsourcing Process

The Uppsala case was not the first time that a home for the elderly had been outsourced to external contractors. One would therefore expect a certain amount of learning to have taken place, leading to a more standardized procurement procedure and a procurement document based on widely used general templates and earlier procurement documents (Forssell and Norén 2004).

We noted before that the procurement document did not contain a detailed specification of the services required. Rather, it constituted a kind of checklist for would-be providers to fill with detail. In this sense it was the providers who specified the services. The checkpoints of the procurement document were used as criteria during the evaluation, and tenders were graded in the procedure described above. Through repetition the procedure becomes standardized and a lot of uncertainty is avoided for all involved. Furthermore, a standardized procedure that at least partly is transparent – for example, the use of an evaluation form – gives the process an

objective appearance that is necessary for the result to be accepted by all involved, including the losers. The standardized and transparent procedure creates an impression of justice and equal treatment (see Blomgren and Sahlin, in this volume).

This last observation points to an interesting paradox. The purpose of public procurements is to construct markets that will make the provision of a certain service or product more effective and efficient. This is translated by the Public Procurement Act into two rules. The first states that services over a certain sum should be procured in open competition and the second that: 'A purchasing unit should choose either the tender that is the most economically advantageous, or the one that has the lowest price' (PPA in SFS 1992, 1528:6, see above). One would think that the first alternative in the second rule would allow a local government to establish an enduring relationship with a certain provider – that is, to apply a relational approach – if that were to be considered 'the most economically advantageous' choice, but this is not the case. Here it becomes evident that the PPA also contains ideas from neo-classical theory: markets are price mechanisms where time, experience and history do not play significant roles; on the contrary, they are considered to be compromising and corrupting influences that should be avoided. Therefore, a transaction approach is applied, which means that all contracts should be limited in time and when they expire a new procurement process should start. In practice the contract period often extends over three years, with a chance of prolonging the contract for another three-year period. But then, the services in question are up for a new tendering process.

This means that the term 'business-like grounds'² is interpreted differently by the PPA to how it would commonly be in many other markets. For instance, private companies normally do not have to purchase services and products using open tendering processes, they can choose to purchase from the provider they prefer for whatever reason, and they are allowed to prolong agreements and contracts as long as they wish. In many markets this is a common business-like practice as the IMP project, cited above, showed (see Ford 1990; Gadde and Håkansson 1993).

Besides the paradox that business practice is interpreted one way by the PPA – the transaction approach – and another way by private companies in other markets – the relational approach – the public procurement procedure also activates certain bureaucratic principles that are strongly associated with the public sector in general. The principles we have in mind are the principles of impartial and equal treatment, the principle of transparency and the principle of standardized procedures (Mintzberg 1983, chapter 10). This activating of bureaucratic principles is typically one of those unintended consequences of reforming (see Gregory, in this volume).

Let us elaborate on this: the whole procurement process described above – from the paragraphs in the procurement document and the handling of the tenders, to the design of the evaluation form and the evaluation process – is to a large extent characterized by bureaucratic principles. The process has been designed to comply with the bureaucratic principles of impartial treatment and a standardized and transparent evaluation procedure. No tender is eliminated as long as it fulfils the formal criteria. Still, the problem of partisan treatment cannot be completely avoided.

2 As stated above, the first paragraph of the PPA states that all public procurement should be made on business-like grounds.

First, because there is no guarantee that the procurement document, particularly the evaluation criteria, will not be written so as to favour some contractors over others. Secondly, because the evaluation processes tend to become ‘beauty contests’, where subjective judgements are inevitable.

So far we can conclude that the transaction approach – keeping providers at arm’s length – at least to some degree seems to work. It has been helped by the standardization and bureaucratization of the procurement procedures, and one would expect this to increase over time, as the purchaser becomes more experienced.

The whole process certainly worked in Uppsala: a provider was chosen and in this case the provider was able to carry on what it was already doing. Still, we believe that there may be other mechanisms at work behind the formal transaction approach that helps the actual provision of services to the elderly at the GV home go more smoothly.

The Purchasers’ Trust in Professional Knowledge and Routines

One reason why the procurement process could be standardized was probably that the service in question – care of the elderly – is regarded by those who work in this field as a well-known and standardized activity, performed in the same way in different places, although it is difficult to specify this in detailed words. This, to a large extent, tacit knowledge that resides in the hands and heads of nurses, assistant nurses, doctors and other professionals and semi-professionals caring for the elderly, acts as a guarantee of the proper operation of the service. This applies not only to care of the elderly, but to many other fields, like adult education, social work and so on. This knowledge is shared by all those involved in the field and also to a large degree by people in procurement units or among providing companies. Therefore there is little need to specify in detail how the services in question should be performed. This knowledge is taken for granted in the same way that it is taken for granted that providers would not deviate radically from this knowledge and the routines connected to it. The purchaser knows, or thinks it knows, what the provider does and how the provider manages operations like these.

Although, as we observed above, a trend during the 1990s was to de-emphasize the role of professionals in the provision of services, it is clear to us that informally there exists a strong reliance on professional knowledge and community. This was verified by Johansson (2004), who attributed the fairly low transaction costs for the outsourcing of care of the elderly in Swedish local governments (c. 2 per cent) to the many informal professional contacts that existed between the partners. It also became clear in our interviews that informal communication was important, particularly after a provider had been chosen. Every three months the provider was expected to present a short formal report, but in between informal contacts were preferred to solve any problem that might occur.

Our analysis of the importance of implicit trust in professional knowledge illustrates the claim by Meyer and Rowan (1977) that confidence and good faith are important prerequisites for upholding day-to-day activities in strongly institutionalized environments. Meyer and Rowan were writing about the decoupling between formal structure and activities in an organization. We claim that a

similar de-coupling takes place between the formal transactional approach towards outsourcing of welfare services and the informal, more relational approach going on behind the scenes.

To further ensure that professional standards are upheld, references to other outsourced operations are important when choosing a contractor; a provider who has not been in the business before encounters more mistrust than providers who can cite earlier experiences elsewhere. This means that a strong barrier to entry exists and that new providers therefore have a tougher time entering the market (Svensson and Edebalk 2001). This further emphasizes the tendency for the whole field to cling to certain professional knowledge, routines and norms.

Experiences from the Field II: New Zealand

Having discussed the outsourcing of welfare services in Sweden, we now turn to New Zealand, which was an early and radical reformer in the New Public Management wave of reforms during the 1980s and 1990s (Boston et al. 1996). Among the reforms, the outsourcing/contracting out of many public services was one of the most prominent. Even more than in Sweden and the EU, the 'contractualism' paradigm (Boston 1995) was driven, or at least strongly supported, by economic theory. But in New Zealand it was not only 'ordinary' neo-classical theory that underpinned the reforms, but also economic institutional theories and in particular principal–agency theory that influenced the regulation and the practice of outsourcing.

According to Cribb principal–agency theory means that 'a principal (government agency) contracts with an agent (...) to deliver services on their behalf. The agent is assumed to have different interests from the principal and as such will act self-interestedly when the opportunity arises. To ensure the agent does what the principal expects them to, external monitoring, reporting, sanctions and incentives are put in place' (Cribb 2005).

The contract is central to relations between the principal and the agent. The performance of the agent can only be measured against the contract, therefore it is important that the contract clearly states what the principal wants and what the agent promises to deliver. Furthermore, it assumes that providers cannot be trusted. Shirking is seen as a big problem, and therefore there is an emphasis on monitoring and control (Cribb 2006).

As stated in the introduction, voluntary organizations play an important role in the provision of social services in New Zealand. But, according to Cribb (2006), relations between the state and the voluntary organizations changed during the 1990s so that grant-based funding was replaced by contracts for the delivery of services. 'By the mid-1990s, voluntary organizations with a funding relationship with government had become service providers. Many had a formal, "classical" contract with government. What they were required to provide, in what quantity, at what quality and price – all this was specified in the contract' (Cribb 2006, 12).

When Cribb interviewed managers and board members of voluntary organizations engaged in contractual relations with the government, a lot of dissatisfaction was

voiced (Cribb 2006). Here we will reproduce at length some of Cribb's most important findings. For instance, respondents perceived that:

- They were viewed as inferior, while officials saw themselves as experts. There was no negotiation or dialogue about the contents of the contract or funding agreements. (...)
- Officials did not trust them. They expected the respondents to defraud the system or produce poor quality work. The integrity and expertise of respondents was not recognised. (...)
- The main form of communication between respondents and officials was monitoring reports. The relationship was distant and paper-based. (...)
- Reporting focused on specific outputs that were often irrelevant to service quality or organizational performance. (...)
- Contracting was an economic tool used to try to maximise efficiency. Respondents perceived that officials took a 'take it or leave it' approach focused on competition between providers to drive down the price of service delivery (Cribb 2006, 12).

This voicing of dissatisfaction can be contrasted with how the respondents saw themselves as being accountable. Here, it was obvious that the respondents:

perceived that they were most accountable to their clients. Providing a quality service to clients was the reason for their organization's existence. Accountability relationships within the organization were of secondary importance. There was a strong chain of internal command and control as well as a degree of collegial obligation. These internal relationships were based on ensuring quality services were delivered. Accountability to government agencies for funds and compliance with regulation was perceived as third most important. Regulatory compliance was seen as a necessary evil and government funding as an input needed to provide services to their clients (Cribb 2005).

In her discussion Cribb concluded that the assumptions of principal–agency theory were dissonant with her findings. The agents, at least the voluntary organization in her study, did not try to shirk, could be trusted and put the clients' interests first (Cribb 2006, 13). Therefore, Cribb suggests, it is time to try another approach towards outsourcing of social services to voluntary organizations. Instead of seeing them as agents, of the principal–agency theory kind, they ought to be looked upon as stewards. That way the relation between funder and provider could be one of co-operation and trust, instead of formality, distance and mistrust.

Conclusions on Outsourcing in Sweden and New Zealand

The purpose of Cribb's study on New Zealand was different to that of the Swedish case study presented above. Still, a comparison of the two studies shows that there are clear similarities but also interesting differences in the way outsourcing is carried out in these two countries.

In both countries a formal transaction approach is applied towards outsourcing. There seems to be more interaction between provider and purchaser in Sweden, even up to the point where it is the provider who specifies the services in question. In New Zealand the providers are not involved in this process. In the Swedish study the purchasers really tried to assess the quality of the different tenders, for instance using formalized criteria when grading tenders, and often by giving weight to certain quality aspects. Also in New Zealand the quality of services was considered to be important, but the providers, who focused on quality of services, thought that the reports were less relevant or even irrelevant to service quality. In general in New Zealand there is a stronger emphasis on monitoring and control than in Sweden. The standardization and bureaucratization of processes that we observed in Sweden, although not explicitly reported by Cribb, probably exist in New Zealand as well: standardization, because outsourcing is common, and bureaucratization because of the very formal procedures reported.

Our most important conclusion from the Swedish case was the frequent occurrence of informal contacts that seemed to function as ‘lubricants’ in relations between purchaser and provider, once a contractor was chosen. This type of informal contact seems to be non-existent in New Zealand. Another trait of the Swedish case was an implicit confidence in a professional knowledge of the field. Again, this seems to be lacking in New Zealand. Instead, respondents from voluntary organizations complained about mistrust and a lack of confidence in their expertise on the part of the purchaser.

The de-emphasizing of the role of professional groups in the provision of welfare services discernible from the late 1990s onwards may present a threat to confidence in professional knowledge in Sweden. This may lead to a situation more resembling that in New Zealand, where the outsourcing of welfare services has been characterized by a more formal transaction approach.

If we summarize our conclusions, one, in particular, stands out: in both Sweden and New Zealand a formal transaction approach is taken by the purchaser towards the provider. In Sweden this is supplemented by a more relational informal approach ‘behind the scenes’. This informal relationship is non-existent in New Zealand and is a probable cause of discontent among providers.

The Difficult Art of Outsourcing Welfare Services

The starting point of this excursion into the ideas and practice of outsourcing welfare services was Donahue’s conclusion that the key premises for successful outsourcing are: 1) that it is possible to specify the task being contracted out in terms of ends (outputs/outcomes); and 2) the importance of competition among providers. In this chapter we have limited our discussion mainly to the first of these premises.

In the Swedish case presented above it is clear that the specification of the services in question, care of the elderly, was very difficult, and the purchaser left the provider to do it. In the New Zealand case the purchaser did the specification. We do not know whether the purchaser found this a difficult task, but we do know that the

providers often found the reports they were being asked to deliver to the purchaser to be irrelevant to service quality.

Are the difficulties involved in specifying services due to shortcomings on the part of the purchasers? To some extent the answer is yes. At least some of the difficulties might be due to a lack of experience, and there is reason to believe that the specifications might become more accurate with time.

But there is another reason for the difficulties that cannot be blamed on the purchasers. This has to do with the nature of the services. In any textbook on services marketing the reader will find a list of characteristics of services that distinguishes them from goods (see, for instance, Jobber and Fahy 2002; Kotler 2005). The characteristics most often mentioned are *intangibility*, *heterogeneity*, *inseparability* and *perishability*. What do these characteristics mean? Saying that services are intangible means that they have no physical or material existence. Because of this they are difficult to assess in advance – they need to be experienced in order to be assessed. Services are heterogeneous, which means that they differ from one instance to another and are therefore difficult to standardize. This is partly due to the fact that in the production and delivery of services, producers/deliverers cannot be clearly separated from the consumers. Consumers participate in the delivery of services: think only of the case of going to the hairdresser. The customer cannot buy a ready-made haircut; he/she needs to take part in its production, if only to sit still in the hairdresser's chair during the process of hairdressing. Finally, the perishability of services means that services are produced and consumed at the same time – think of the haircut – and cannot be stored.

Because of these characteristics, services are difficult, even impossible, to specify in detail. You can try to explain to the hairdresser how you wish your hair to be cut, but no matter how hard you try, you cannot in detail specify exactly what you want. What you typically end up with is a fairly broad and vague description of what you expect. This is quite different from the specification of a good. Whether it is a matter of producing a table or a new university building, these physical products can, more or less easily, be specified in detail beforehand.

Grönroos (1998) claims that the inseparability and perishability of services follow from a more basic trait, namely 'the process nature of services'. Physical goods are preproduced in a factory, whereas services are produced in a process in which consumers interact with the production resources of the service firm (Grönroos 1998, 322). The welfare services referred to in this chapter typically involve this kind of interaction. This line of reasoning furthermore leads Grönroos to claim: 'the consumption of a service is a process consumption rather than outcome consumption' (Grönroos). When applied to the outsourcing of welfare services, this might lead purchasers to emphasize the processes involved in the services in question rather than trying in vain to specify outputs that cannot fully be specified.

So, Donahue's first condition for the successful outsourcing/purchasing of services – specification of the service in question – is obviously difficult to meet. In the business sector this problem is often overcome by establishing long-lasting relations with suppliers. In the public sector, when a transaction approach to outsourcing is applied, this problem must be overcome in other ways. We have suggested at least two such solutions: the first is to standardize the purchasing process, enabling both

purchasers and suppliers to draw on former experiences of tendering processes. The second is to rely heavily on a professional, more or less tacit, knowledge, and to avoid specifying the services in detail. Instead, more emphasis is put on procedures like quality systems, that is, on the 'means', to use Donahue's words. However, if this is done, Donahue's recommendation would be not to outsource.

Are There Alternatives to Outsourcing?

Besides the special nature of services (as opposed to goods), there is another idea in the marketing literature that may point to alternatives to outsourcing. What we have in mind are the different roles involved in purchasing. These include the purchaser, who decides on the purchase; the funder, who pays for the product; and the consumer, who receives and consumes the product (Jobber and Fahy 2002; Kotler 2005). It is often taken for granted that these roles coincide, but in many cases they do not. For instance, when outsourcing, the entire operation of a service is contracted out to another, usually private, provider. The public organization then assumes the role of funder and purchaser, acting on behalf of the taxpayers, who among them encompass the consumers. In public-private partnerships the private partner is often responsible for both the funding and the actual provision of the services in question. This means that the roles of funder and provider are assumed by the private partner, while the public sector is limited to the role of purchaser. The consumers, on the other hand, are the citizens (for most services). Finally, in voucher systems, the public sector functions only as the funder, while the citizens take on the roles of purchasers and consumers, and the private organizations the role of providers.

Donahue paid attention to the roles of funder, purchaser and provider, but ignored the role of the consumer. This is logical for two reasons: first, the funder and purchaser are the same in outsourcing; and second, the purchaser and the provider play the key roles. However, if we focus instead on the interests of the consumer, it becomes obvious that the voucher system is the only market mechanism of the three that gives the key role to the consumer. From a consumer's point of view then, the voucher system is the preferable one (Norén 2003). Voucher systems are probably not useful in all types of services, for example, where the service is a collective, non-exclusive good (Ahrne 1994). But in most welfare services, like health care and education, the services are provided individually, and therefore it would be possible to apply a voucher system more generally.

Voucher systems are also beneficial for smaller providers, running only one operation, such as a home for the elderly, which risk liquidation every time the operation it is running comes up for a new compulsory tendering process. This is less likely to happen if a voucher system is used. Voucher systems are thus not only better for consumers; they also satisfy Donahue's second condition better, namely the importance of competition among providers. Outsourcing, on the other hand, tends to lead to a concentration of providers and therefore to restrict the degree of competition among providers. This is because the risk of losing contracts can only be assumed by organizations that can operate on a larger scale. They can thus dilute

the risk of losing contracts and avoid the all-or-nothing situation that each tendering process presents.

Another solution, not available to Donahue, who was applying transaction cost theory with its binary make-or-buy options, is to use a relational approach, learning from the many industrial firms that do apply it. To use a relational approach seriously would mean to engage in longer and more stable relationships with providers. It would also mean, though, that we would get closer to the market mechanism of public-private partnership (PPP), which features exactly these characteristics. In this way it is possible to view PPP as a transformation and development of the 'privatization' issue that Donahue dealt with (see Greve and Hodge, in this volume).

And finally, the last alternative to outsourcing, of course, would be not to outsource at all, but to choose the 'make-it-yourself' alternative. The argument here would be based on transaction cost theory and start with the nature of services. We know now that services are difficult, even impossible, to specify in detail. The more effort the purchaser puts into the specification of a service, the higher the transaction costs. High transaction costs was basically the explanation Coase (1937) gave for the existence of the Firm, as opposed to the Market. Transaction costs include costs for searching for and obtaining information on the market, costs for bargaining and for writing contracts with suppliers, and costs for policing and monitoring delivery (see Coase 1988, 6). If transaction costs become too high, then it is less costly to internalize them, that is, to avoid the search for suppliers, the elaboration of detailed specification, time-consuming bargaining, and so on, and instead supply the service oneself. Then one's control of the process is much stronger and a more incremental, ongoing approach towards specification can be applied – the services do not need to be specified in detail beforehand. Instead, specification might evolve during the process.

To conclude, what are the alternatives to outsourcing? The answer, based on theoretical reasoning, would be voucher systems, because they give first priority to consumers; PPP, because it is able to utilize the full potential of the relational approach; and own-service production, because it minimizes transaction costs. In this comparison, outsourcing emerges as the least preferable alternative. But what we have also seen is that a less doctrinaire application of the transaction approach could be both effective and efficient, once we allow the transaction approach to be supplemented by a relational, or even a stewardship, approach.