

Efficiency of outsourcing and factors determining it: Slovakia

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1. Introduction

Contracting/outsourcing public services to private for-profit and non-profit firms represent the most common types of alternative service-delivery arrangements. The relevant literature focusing on the developed countries conditions, suggests that if, and only if the contracting/outsourcing are properly implemented, then they may, but need not improve individual choice, cost-effectiveness, delivery quality, equity, and expenditure control. In countries making the transition from socialism to market-based economies, or other transitional countries, the situation is much more complicated, as this chapter confirms.

In this text we provide data about results from outsourcing in Slovakia and test the factors determining their success. Despite some methodological problems, the data suggests that externalization of production generally delivers neither improved efficiency nor quality compared with internalized production. Although the data overall supports the case for internalization, it also reveals examples of effective outsourcing, thereby indicating the potential value of contracting if it is properly implemented. The main determinants of success of outsourcing are also evaluated.

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2. Outsourcing in Slovakia and its efficiency

Our data about outsourcing processes in Slovakia indicate that external production of internal services in public organizations is not rare, but relatively frequent solution –Table 1 highlights one of our samples.

Table 1: Frequency of use of outsourcing of internal services – Slovakia, sample of 127 organisations, 2009

Public organization branch	Internal service					Non-weighted average
	Catering	Maintenance	IT	Transport	Security	
Culture	62,50 %	25,00 %	37,50 %	0,00 %	42,86 %	
Social service	20,00 %	42,86 %	25,00 %	0,00 %	0,00 %	
Education	17,74 %	14,52 %	27,59 %	15,15 %	42,50 %	
Administration	90,00 %	27,59 %	25,00 %	3,70 %	64,00 %	
Health care	21,43 %	35,71 %	42,86 %	7,14 %	45,45 %	
Non-weighted average						

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Note: own research

3. 1 Efficiency of outsourcing in Slovakia

In this part we try to estimate efficiency of outsourcing using data collected by our own research.

Methodological base

The technical efficiency of service delivery arrangements can be measured by parametric and non-parametric evaluation methods, which permit simultaneous comparison of the inputs and outputs of a service production and produce concise indicators of efficiency. Both methods allow considering the heterogeneous character of the output produced by different decision making units (DMUs) and are particularly well-suited for developing indicators to compare the efficiency of different service delivery arrangements (Fiala, Jablonský, Mañas, 1994; Lysá, 2002).

Since each method is based on different hypotheses with differing degrees of stringency, they will lead to different (sometimes contrasting) results regarding the efficiency levels of the service delivery arrangements examined. Parametric analyses require a prior definition of a production function of services, whereas the non-parametric analyses determine the relative efficiency scores of similar service delivery arrangements by means of linear programming techniques, without detailed descriptions of their production processes (Murtag, Heck, 1987; Vlček, 2004).

Given the multi-output nature of the public organisations involved in analysis, we will focus on a particular non-parametric method, the Method of best values of indicators (MBVI), which is encountering growing consensus as a powerful tool to measure public organisations productivity because it allows the heterogeneity of delivered outputs to be taken into account (Hinloopen, Nijkamp, Rietveld, 1982; Ochrana, Nekola, 2009). MBVI as the nonparametric multidimensional approaches to the evaluation of efficiency of Decision Making Units (DMU) is based on a weighted sum algorithm (Charnes, Cooper, Rhodes, 1978). Here we designated the service delivery method as a DMU.

As it uses a particular type of linear programming, MBVI makes it possible to determine the efficiency score of service delivery arrangements (DMU) without the need for a detailed description of the production process and to express the efficiency of evaluated DMUs, taking into consideration multiple indicators, measured in different units (Murtag, Heck, 1987; Vlček, 2004).

MBVI is particularly useful when input total costs are not available, thus making it impossible to estimate a service cost function. This is the case of most Czech public organisations, where the accrual accounting does not work (Meričková, Nemeč, Ochrana, 2008; Nemeč, Ochrana, Šumpíková, 2008).

MBVI as one of the nonparametric multidimensional approaches to the evaluation of efficiency of Decision Making Units (DMU) based on a weighted sum algorithm is used to the efficiency evaluation of internal service delivery arrangements (outsourcing and in-house production).

Following Žižka (1988, 146-147), we consider m service delivery arrangements - alternatives A_i ($i = 1 \dots m$), and n indicators of evaluation K_j ($j = 1 \dots n$). When we assign empirical val-

ues for all delivery alternatives and evaluation indicators, we obtain the evaluation matrix X. Because indicators use different measurement units we normalize their values x_{ij} as follows:

If the best value of the indicator is its maximum value, we normalize by:

$$a_{ij} = \frac{x_{ij}}{x_{\max}} \quad (1)$$

If the best value of the indicator is its minimum value we normalize by:

$$a_{ij} = \frac{x_{\min}}{x_{ij}} \quad (2)$$

Thus we generate a matrix of normalized indicator values (A), which fall in the interval (0, 1). Then we assign the weights v_j to the indicators, where:

$$\sum_{j=1}^n v_j = 100 \quad (3)$$

The final evaluation of the efficiency of each alternative is obtained by multiplying matrix A by the column vector of weights v_j :

	Indicator	Weight of indicator	Final evaluation																																																	
Alternative	<table style="border-collapse: collapse; margin: 0 auto;"> <tr> <td style="padding: 0 10px;"></td> <td style="padding: 0 10px; text-align: center;">K1</td> <td style="padding: 0 10px; text-align: center;">K2</td> <td style="padding: 0 10px; text-align: center;">K3</td> <td style="padding: 0 10px; text-align: center;">K4</td> <td style="padding: 0 10px; text-align: center;">...</td> <td style="padding: 0 10px; text-align: center;">Kn</td> </tr> <tr> <td style="padding: 5px 10px 5px 10px;">a_{11}</td> <td style="padding: 5px 10px 5px 10px;">a_{12}</td> <td style="padding: 5px 10px 5px 10px;">a_{13}</td> <td style="padding: 5px 10px 5px 10px;">a_{14}</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">a_{1n}</td> </tr> <tr> <td style="padding: 5px 10px 5px 10px;">a_{21}</td> <td style="padding: 5px 10px 5px 10px;">a_{22}</td> <td style="padding: 5px 10px 5px 10px;">a_{23}</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">a_{2n}</td> </tr> <tr> <td style="padding: 5px 10px 5px 10px;">a_{31}</td> <td style="padding: 5px 10px 5px 10px;">a_{32}</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">a_{3n}</td> </tr> <tr> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> </tr> <tr> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> </tr> <tr> <td style="padding: 5px 10px 5px 10px;">a_{m1}</td> <td style="padding: 5px 10px 5px 10px;">a_{m2}</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">.</td> <td style="padding: 5px 10px 5px 10px;">a_{mn}</td> </tr> </table>		K1	K2	K3	K4	...	Kn	a_{11}	a_{12}	a_{13}	a_{14}	.	.	a_{1n}	a_{21}	a_{22}	a_{23}	.	.	.	a_{2n}	a_{31}	a_{32}	a_{3n}	a_{m1}	a_{m2}	a_{mn}	$\begin{pmatrix} v_1 \\ v_2 \\ v_3 \\ . \\ . \\ v_n \end{pmatrix}$	$= \begin{pmatrix} h_1 \\ h_2 \\ h_3 \\ . \\ . \\ h_m \end{pmatrix}$
	K1	K2	K3	K4	...	Kn																																														
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The most efficient service delivery alternative is the option with maximal composite score E. The composite efficiency of other options is given proportionally to alternative E max.

For the purposes of our research we have chosen following:

- The costs of service delivery per employee
- The unit costs of service delivery (Table 4)
- The quality of service.


Table 4: Selected calculations units for evaluated services

Service	Calculation unit
Cleaning	m2
Catering	Number of users
Maintenance	Number of actions
IT	Number of actions
Transport	Average km yearly
Security	m2 of protected area

Note: own research.

For internal services in public organisations we have to acknowledge that measuring the quality of a service is generally much more difficult than measuring the quality of a good. Service quality may be identified in terms of performance characteristics, but their assessment may require subjective judgments. It can be measured through user satisfaction, but this is subjective because individual opinions on what constitutes a high standard of service quality may vary from one user to another. To cope with this problem as well as possible we follow the research methodology of several existing studies in area of service quality evaluating in public sector (Löffler 201; Wisniewski 2001; Potůček 2005). Data on service quality were provided by the users, the employees of different public organisations, through a questionnaire. The samples are non-representative (total 420 persons interviewed), so we accept that our summary data are partly preliminary.

For the purposes of our research the employees evaluated service quality using the following scale:

Absolutely satisfied	100 %	 Rate of satisfaction
Satisfied	80 %	
More satisfied than unsatisfied	60 %	
More unsatisfied than satisfied	40 %	
Unsatisfied	20 %	
Absolutely unsatisfied	0 %	

To calculate MBVI we assigned weights (v_j) to the indicators (Table 5). To set the weights we used Saaty's method (Saaty et al., 1983) with inputs from a panel of experts on outsourcing.

Table 5 Weights (v_j) assigned for selected indicators

Indicator	v_j %
Unit costs of service delivery per employee	30
Unit costs of service delivery per service outcome	30
Quality of service	40
Σ	100

Note: own research

Research results Slovakia

The planned sample was 300 public organisations from main sub-sectors - education, health care, social care/ services, culture and sport, general administration; unfortunately only 127 organisations responded (sample described in the Table 3). The results of calculations are provided by the Table 6.

Table 6 Efficiency of internal versus outsourced services Slovakia

		Administration	Education	Health care	Social	Culture
Cleaning	Internal	94,88	82,48	100,00	-	100,00
	Outsourced	100,00	100,00	70,33	-	94,85
Catering	Internal	90,09	70,91	100,00	56,50	78,60
	Outsourced	100,00	100,00	87,03	100,00	100,00
Maintenance	Internal	53,06	100,00	100,00	91,01	100,00
	Outsourced	100,00	90,52	70,01	100,00	85,61
IT	Internal	75,16	69,76	100,00	63,20	62,35
	Outsourced	100,00	100,00	76,27	100,00	100,00
Transport	Internal	98,38	51,06	100,00	-	-
	Outsourced	100,00	100,00	93,00	-	-
Security	Internal	84,94	67,84	100,00	-	51,60
	Outsourced	100,00	100,00	85,16	-	100,00

Source: own research

3. Testing the “quality” of contract management for outsourcing

Together with low quality “ex-ante analysis” (see above), the absence of systemic contract management is one of the core purposes for failures of contracting (Hodge 2000; Sclar 2000; Brudney et al. 2005, Kamerman and Kahn 1989; Stejskal, Charbusky, 2004). The literature suggests that the following factors determine the success of contracting related to 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); the 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 2003; Hefetz and Warner 2004); 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 stress relational contracting as 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 deal with communication and joint problem solving between principal and agent as determinants of contracting performance (DeHoog, 1990; Sclar, 2000; Macneil, 1978).

Research results

For the purposes of this analysis we used specific sample of Slovak municipalities, characterised by the Table 2.

Table 2 The research sample

Size of municipality	Total	Sample		% from total	
		2009	2010	2009	2010
Bellow 999	1 926	49	34	2,54	1,70
1 000 - 4 999	833	56	58	6,72	7,00
5 000 - 9 999	60	9	17	15,00	28,33
10 000 - 19 999	32	8	12	25,00	37,50
20 000 - 49 999	29	9	14	22,50	48,28
Over 50 000	11		6		54,55
Total	2 891	131	141	4,53	4,88

Source: Statistical Office Slovakia

For the purposes of this concrete research of the quality of contract management in outsourcing we decided to use following set of factors (determined by Deplhi method from larger set of possible factors):

A: Procurement process:

x_1 – level of competitiveness of the award

x_2 – definition of the procured services

B: Selection process:

x_3 - selection criteria

x_4 - ex-ante evaluation: financial situation of suppliers

x_5 – ex-ante evaluation: technical capacities of suppliers

x_6 – ex-ante evaluation: human resources of suppliers

x_7 – ex-ante evaluation: experience of supplier

x_8 – experience of the contractor

C: Contract conditions:

x_9 - frequency of monitoring

x_{10} - sanctions

D: Relations supplier and contractor

x_{11} – method of payment to supplier

x_{12} - communication with supplier

x_{13} - quality of cooperation between supplier and contractor

x_{14} - level of trust between supplier and contractor

All above mentioned factors have qualitative character, thus we transformed them into quantitative data as described by the Table 3.

Table 3 Conversion of qualitative factors to quantitative data

Factor	x_1 - level of competitive-ness of the award																					
Description																						
Open tender	100	x_2 – is the service properly defined in the contract?	x_4 - ex-ante evaluation: Did the contractor evaluate financial situation of potential suppliers?	x_5 - ex-ante evaluation: Did the contractor evaluate technical capacities of potential suppliers?	x_6 - ex-ante evaluation: Did the contractor evaluate human resources of potential suppliers?	x_7 - ex-ante evaluation: Did the contractor evaluate previous cooperation of potential suppliers with public sector?	x_8 – has involved contractors’ staff sufficient expertise?	x_{13} – the quality of cooperation between supplier and contractor is high.	x_{14} – the level of trust between supplier and contractor is high													
Restricted procedure	70																					
Negotiated procedure	50																					
Price quotation	30																					
Direct award	0																					
	Fully agree	100	100	100	100	100	100	100	100	x_3 – selection criteria	x_9 - Frequency of monitoring	x_{10} – Contract sanctions	x_{11} - method of payment to supplier	x_{12} - communication with supplier								
	Agree	50	50	50	50	50	50	50	50													
	Disagree	0	0	0	0	0	0	0	0													
	Fully disagree	0	0	0	0	0	0	0	0													
										Best bid	100											
										Lowest price	50											
										Regular	100											
										Irregular	50											
										No monitoring	0											
										Cancellation of the contract	100											
										Financial sanctions	70											
										Right to request improvements	30											
										Other	0											
										Performance payment	100											
										Mixed performance and lump sum payment	50											
										Lump sum payment	0											
												Frequent	100									
												Regular	70									
												Irregular	30									
												Limited or no at all	0									

Note: own research

The calculations for all factors are provided by the Tables 4 to 7. The average quality is app. 60%, what is not very good mirror for the practice.

Table 4 Quality of contract management for outsourcing internal services: procurement process

	Competitiveness	Defining the service
Cleaning	45,28	57,50
Catering	32,91	65,22
Maintenance	52,11	69,86
IT management	38,52	61,28
Transport	28,81	69,14
Security	37,14	60,94
Average	39,13	63,99

Note: own research

Table 5 Quality of contract management for outsourcing internal services: selection criteria

	Selection criteria	Financial capacities: supplier	Technical capacities: supplier	Human capacities: supplier	Experience of supplier	Contractor capacity
Cleaning	58,34	33,34	51,95	54,17	45,28	48,06
Catering	73,90	61,69	67,28	63,08	62,79	69,69
Maintenance	73,83	67,98	77,86	71,60	67,12	74,16
IT management	71,39	59,26	73,81	69,49	67,38	64,53
Transport	69,58	63,56	69,63	62,78	48,58	58,97
Security	57,25	51,10	63,81	56,71	55,84	66,50
Average	67,38	56,15	67,39	62,97	57,83	63,65

Note: own research

Table 6 Quality of contract management for outsourcing internal services: contract conditions

	Monitoring	Sanctions
Cleaning	56,95	57,22
Catering	55,25	67,46
Maintenance	63,43	50,32
IT management	58,97	51,39
Transport	71,25	48,25
Security	59,52	45,76
Average	60,9	53,4

Note: own research

Table 7 Quality of contract management for outsourcing internal services: supplier x contractor relations

	Payment	Communication	Cooperation	Trust
Cleaning	31,39	60,84	59,17	46,39
Catering	56,32	60,68	78,42	73,71
Maintenance	74,81	59,76	83,65	75,54
IT management	58,02	62,25	76,33	70,61
Transport	75,00	49,22	74,61	64,81
Security	47,05	48,99	72,15	72,23
Average	57,1	56,95	74,05	67,22

Note: own research

The data obtained by our direct research indicate that the quality of contract management is limited. Better results are normally received for “soft” indicators, where evaluation is based on the subjective opinion/response from the staff involved. Critical level is achieved for main “hard” indicators, especially level of competitiveness.

Testing the relation between factors and results of contracting/outsourcing

In this part we calculate the Spearman correlation coefficient to test the correlation between dependent variable (efficiency of contracting/outsourcing – data not included in this paper) and independent variables – respective quality of contract management factors. With the $\alpha = 0,1$ we tested with statistical systems R and IMB following:

$H_0: \rho_s = 0$ (no statistically important correlation)

$H_1: \rho_s \neq 0$ (statistically important correlation exists)

The results are provided by Table 14.

Table 13 Correlations for outsourcing internal services

Service	Factor	p - value	Spearman coefficient	Correlation
Cleaning	x_3	0,062	-0,579	Negative
	x_{14}	0,027	0,659	Positive
Catering	x_1	0,003	0,329	Positive
	x_4	0,034	0,242	Positive

	x ₅	0,061	0,215	Positive
	x ₆	0,008	0,301	Positive
Maintenance	x ₁	0,004	0,444	Positive
IT	x ₂	0,053	-0,221	Negative
Transport	x ₁	0,064	0,384	Positive
	x ₁₃	0,018	0,478	Positive
Security	x ₁	0,002	0,481	Positive
	x ₂	0,071	0,288	Positive
	x ₃	0,005	-0,431	Negative
	x ₄	0,013	0,391	Positive
	x ₈	0,028	0,347	Positive
	x ₁₃	0,035	0,334	Positive

Note: own research

The data calculated by our research indicate that besides the level of competitiveness, factors like selection criteria, quality of ex-ante evaluation, cooperation and experience also play important role.

The core problem, visible from our findings, is that despite the fact that the competition is the most important factor for success of externalisation (as all authors argue), this contract management factor receives lowest marks. Slovak municipalities avoid competitive contracting despite it is compulsory on the base of the public procurement legislation. Such situation may be the typical problem for all developing economies, significantly undermining the chance for positive results from contracting and outsourcing in transitional countries.

4. Conclusions

Our paper provides data about scale of outsourcing and their results and tests the quality of contract management for externalisation using concrete data from Slovakia. Our data indicate that there are several important factors limiting success of outsourcing in the conditions of selected countries. The most important is probably the degree of competition for the contract. In the Slovak conditions too few contracts follow a competitive bidding process between would-be suppliers. Our full set of data covers more than a decade, and it is clear that this problem is not improving, what might be common problem for all transitional countries. 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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