THE SEPARATION/SPECIFICATION DILEMMA IN CONTRACTING: THE LOCAL GOVERNMENT EXPERIENCE IN VICTORIA

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This article draws on evidence from case studies of local government contracting in the Australian state of Victoria. It argues that one of the key elements of competitive tendering – the separation of purchasers from providers – undermines another of its essential mechanisms – the specification of services – at the point where previously in-house services are exposed to competition. The managers who are to become purchasers lack the requisite knowledge of services, which instead resides in the minds of the service delivery staff whose work is to be subjected to competitive processes. Separating purchasing from service-provision ‘distances’ the staff from the managers, impairing employees’ willingness to share the relevant information. At the same time, the introduction of competition increases the probability that staff will withhold that knowledge, and makes it harder on probity grounds to maintain the type of collaborative relationship which might overcome their reluctance to share it.

INTRODUCTION

For its proponents, the set of practices embodied in the contracting of public services seems coherent. Each of its characteristic elements – the separation of service-provision from purchasing, the specification and monitoring of services, and the establishment of competition among providers – fits within a logical whole. Its animating rationale is to subject service-providers to the discipline of competition, so that purchasers can choose the best or cheapest suppliers, or dispense with poorly performing ones. But in order to do that, purchasers need to specify and monitor the services in question, so that they can see clearly what they are getting and choose among suppliers. This need to specify the service in turn dictates that those entities currently providing services in-house are distinguished from other functions, both to disentangle them, but also to enable the purchasing function to operate separately and therefore more objectively. Thus, competition requires specification, which in turn requires purchaser-provider separation, with the putative result being more effective and efficient service-delivery.

This article brings to light a contradiction between these elements of contracting in those situations where previously in-house services are being opened up to external competition for the first time. It draws evidence from case studies of local government contracting to show that a purchaser-provider split makes it harder for a government purchaser, who often lacks the requisite knowledge of users’ needs and production processes, to specify services, because such a split impairs the relationship with those who possess that knowledge: in-house service-delivery staff. Moreover, the introduction of competition both increases the likelihood that in-house staff will withhold that knowledge, and makes it harder on perceived probity grounds to maintain the type of collaborative relationship which might induce staff to share their knowledge with the
purchaser. This contradiction undermines the coherence of the contractual model as it applies to government services.

These findings draw on documentary evidence and interviews with managers, staff and service-providers from five local authorities which undertook radical processes of government contracting in the Australian state of Victoria. They help to fill specific gaps in the large and growing body of work that has subjected the contractualist model, and the claims made for it, to critical analysis.

In the section that follows, we review the research on government contracting, and delineate the specific gaps on which this article is focused. Following a description of the setting and methods, we present our key findings, firstly in respect of purchaser-provider separation, then of service specification. The final section draws these findings together and discusses their implications.

GOVERNMENT CONTRACTING: PROONENTS AND CRITICS

The conventional model

Once a decision has been made to engage in contracting, its implementation entails three separate but related tasks, widely recognized in the theory and practice of government outsourcing as: (1) separating the responsibility for purchasing services from that for providing those services; (2) specification by the purchasers of the services to be provided (preferably in output terms); and (3) subjecting service-providers (including internal ones) to competition. The ideal, according to proponents, is a situation where

the government manager clearly articulates the policy, sets the performance standards, and chooses in a competitive market an agent who will faithfully act in the government’s behalf to deliver the goods and services so that the outcome sought will be attained. (R.M Kelly 1998, p. 205)

This contracting ideal is set out in linear fashion in figure 1. According to economic theory and government contracting advocates, a range of benefits accrue from this process

![Figure 1: An idealized model of government contracting](image)
including increased efficiency, reduced costs and enhanced quality (Cubbin et al. 1987; Domberger et al. 1995; Industry Commission 1996; Nelson 1997).

This article focuses on two of three ‘tasks’ depicted in figure 1: separation and specification. The third task – competition – has attracted considerable attention, especially in the quasi-markets that developed in the British National Health Service (NHS) and the local government domain in Britain (Le Grand 1990, 1991; Stewar and Walsh 1992; Chaundy and Uttley 1993; Walsh 1995; Walsh et al. 1997; Hughes et al. 1997; Vincent-Jones 1997; Exworthy et al. 1999. For more recent critiques, see Obermann and Kostal 2003; Van Slyke 2003; Brown and Potoski 2004; John and Ward 2005; Brown et al. 2006).

As Bennett and Ferlie (1996) noted, this emphasis on examining the development of quasi-markets has been to the detriment of our understanding of the contracting process itself. Despite contracting constituting the ‘key mechanism of the market’, we still know little about how this happens in practice, largely because it has been seen as a ‘technical’ process (Bennett and Ferlie 1996, p. 53) – a recent exception being Brown et al. (2006) which provides a good overview of issues related to the contracting process.

Purchaser-provider separation

The theoretical rationale for separation of purchasers from providers, first articulated by the public choice school, was that self-interested bureaucrats responsible for both policy advice and service provision had an inbuilt incentive to maximize budgets (for example, Downs 1957; Niskanen 1971; Ostrom and Ostrom 1971; Savas 1982). With separation of the two functions, policy-makers would no longer be motivated to enlarge the resources expended on services, but rather to ensure the efficient delivery of outputs through the creation of new incentive structures. Proponents of separation, such as Osborne and Gaebler (1992), pointed to a range of potential benefits. Separation would clarify the principal-agent relationship, clearly set out the respective roles of purchasers and providers, and allow for accountability, control and responsibility to be assigned to the parties (Ernst 1996; R.M. Kelly 1998), enabling purchasers (or ‘steerers’) to focus on more strategic policy issues (Boston et al. 1996; Stewart 1996), and providers (or ‘rowers’) to focus on service delivery issues (Matheson 1997).

This idealized model of separation has been the subject of considerable research. One focus of theoretical work has been on how and why separation will (or will not) be effective (see, for example, Dunleavy 1991; Self 1993; Walsh 1995). Writers in this vein attempted to cast doubt on the extent to which purchaser-provider separation could deliver the improved performance claimed by its proponents. However, their claims have rarely been supported by empirical research, instead relying heavily on assertion (see, for example, Hunter 1999 which discusses the paucity of empirical research, following this with claims which themselves lack empirical support).

A similarly spirited theoretical discussion has focused on a distinct yet critical issue: whether such separation is actually possible. Several writers have pointed to the difficulty of drawing a definitive line between purchasing and provision functions (Le Grand and Bartlett 1993; Walsh 1995; Stewart 1996; Klijn 2002). Stewart (1996) in particular articulated a set of conditions necessary for separation to work, including, inter alia, that a clear dividing line existed between policy-making and implementation, to enable accountability relationships to be established. In the absence of such conditions, he suggested a range of problems could emerge, including uncertain accountability relationships, fragmentation, and barriers to learning. Le Grand and Bartlett’s (1993) work in the NHS also provided some guidance on optimal conditions. They argued that there needed to be a
good exchange of information between purchasers and providers to avoid opportunism and to provide adequate motivation for both parties. Similarly, Scrivens and Henneh (1989) proposed that: (1) purchasers must be able to negotiate the ‘best’ deal and put in place output measures; and (2) providers must be motivated to attract resources and there should be no room for supply-side distortions (for example, collusion) (see also Mulholland and McAlister 1997).

While the theoretical discussion has been robust, there has been relatively limited empirical investigation of critical issues related to purchaser-provider separation, one major exception being the work of Le Grand and colleagues (for example, Le Grand 1990, 1991; Le Grand and Bartlett 1993; Robinson and Le Grand 1994; Le Grand 1999) on the creation of quasi-markets in the British NHS. This programme of research has provided considerable insight into government contracting. However, the specific purpose of the NHS reforms was to create internal markets (that is, government providers) as opposed to the mixed market models (that is, public and private providers) that were the goal of local government reforms (Mulholland and McAlister 1997). Hence, there are limitations in comparing these reforms with other marketization experiments (see Mulholland and McAlister 1997 who propose a range of difficulties in doing this even within the UK health system).

The available empirical literature suggests that purchaser-provider separation has had limited success in actually improving the performance of service-delivery agencies (for example, Mulholland and McAlister 1997; Aulich 1999; Talbot 2004). Mulholland and McAlister (1997), in an empirical test of Le Grand and Bartlett’s (1993) theoretical conditions in the Northern Ireland Health Service, found that while responsiveness improved to a degree, there was little evidence of improved efficiency, choice or equity, most likely due to an inability to meet the theoretical conditions in practice. Deakin and Walsh (1996) have shown that the relationship between purchasers and providers deteriorates in the period immediately following the introduction of a (quasi) contract, due to difficulties in assigning responsibilities to each party (1996, p. 43). In contrast, Zolkiewski (2004) assessed separation more positively, showing that it had led to improvements in service delivery in the NHS. Another group of researchers have considered the formal content and operation of purchaser-provider relationships but have not focused findings on performance or effectiveness (for example, Jost et al. 1995; Smith 1996; Fischbacher and Francis 1998; Locock 2000). To date, then, there remains a fairly limited empirical body of work examining the relative effectiveness of separation, outside the experiences of the NHS in Britain.

Empirical investigation on the different question of whether separation of purchasers and providers is feasible has been extremely limited. Ernst and O’Toole (1999) found that in rural councils in Victoria, Australia, even though purchaser-provider splits had been enacted, modifications were often instituted which detracted from the ‘purity’ of these separations. Similarly, Aulich (1999) argued that the extent of separation varied widely in Victorian municipal councils. Gallego (2000) found that budget structures blurred separation in the Catalan health system. More recently, Talbot (2004) assessed whether the UK Next Steps agencies had actually been set up as envisaged and he found that broadly they had. It is important to note, however, that he did not specially examine the issue of whether a clear line had been drawn between policy and implementation within each agency. Given the centrality of the separation principle, it is surprising that the issue of whether separation can, in practice, be enacted has been subject to such limited empirical investigation.

In sum, the existing literature provides a relatively good coverage of theoretical issues related to the separation of purchasers and providers – both why separation will (or will not) be effective, and its feasibility. However, there is limited empirical coverage of
whether in practice separation is possible and/or effective. One of the aims of this paper is to address this gap by reporting findings from the local government sector in Victoria.

**Service specification**

The second critical component of government contracting is the specification of services, which commonly involves the formalization of long-held custom and practice, since purchasers determine the service they wish to buy. It underpins the competitive model by setting the service parameters within which providers can compete for government business, and also delineates the purchaser-provider relationship by setting out the responsibilities and accountabilities of each party, underpinning contractual or quasi-contractual arrangements (that is, internal service agreements) (Chaundy and Uttley 1993; Uttley and Hooper 1993; Locock 2000).

To date, the discussion on service specification and monitoring has been largely theoretical and has focused on the relative ease of specification. There is an extensive literature which has argued that at least some types of services are difficult to specify in output or outcome terms *ex ante*, and to monitor *ex post* (Williamson 1979, 1985; Donahue 1989; Jost *et al.* 1995; Deakin and Walsh 1996; Smyth 1997; Behn and Kant 1999; Hodge 2000; Entwistle *et al.* 2002; Klijn 2002; Romzek and Johnston 2005). There has been considerable discussion, for example, on the potential challenges of specifying non-manual or social services: ‘There are difficulties of writing down complex services in specifications, which has been apparent in the cases of health and social care’ (Deakin and Walsh 1996, p. 37). There has also been discussion of conditions where contracting might be more or less successful: ‘When governments can write detailed contracts describing exactly what action the vendor should take and what outcomes the vendor should achieve, the risks of contract failure are low’ (Brown and Potoski 2003, p. 277). Factors posited to explain these difficulties include uncertainty as to future service requirements, information asymmetry and interdependency between the purchaser and provider, and asset specificity.

Although there has been extensive theoretical discussion of this issue, there has been less empirical investigation. It was touched on in Locock’s (2000) study of rationing and the move to ‘explicitness’ in the NHS, and in Leat and Perkins’ study of care package purchasing (1998). Savas (2002) discusses the ‘good practice’ of purchasers in New York City social services and explains what was included in specification for services such as home care (for example, employee qualifications and record keeping requirements) and homeless shelters (for example, occupancy rates, length of stay and rules for residents). However, he does not tell us much about how the information for these specifications was obtained. For proponents, specification has been viewed as a simple technical task (Bennett and Ferlie 1996).

This discussion has tended to leave unaddressed the issue of whether the purchaser has sufficient information about and understanding of the service to be able to specify it, especially in output or outcome terms. This may be problematic if that knowledge is held by people other than the purchasers, such as those who have historically provided the service. To the extent that purchasers are not privy to this information and understanding, they do not know what they want the service-provider to do for them, much less frame that in terms of output specifications. This issue has been subject to very little theoretical consideration, and even less empirical investigation.

The key exception at the theoretical level is the work of Deakin and Walsh (1996, p. 37); they suggested that challenges might emerge in specifying complex social services.
since purchasers were potentially dependent on providers for knowledge on what ‘was’ done and what ‘should’ be done. They suggested this could form the basis of a ‘battle-ground’ in the NHS.

SETTING AND METHODS

Between 1992 and 1999, to at least as great an extent as the governments of the United Kingdom and New Zealand in the 1980s and early 1990s, the Australian state of Victoria adopted contractualist government wholeheartedly. The newly elected Liberal-National state government, which took control of both houses of parliament, set about enacting a radical programme of reforms informed by economic theory and the emerging ‘reinventing government’ movement (Alford and O’Neill 1994). The most dramatic changes were targeted at local government, where compulsory competitive tendering (CCT) was introduced in 1994 as ‘... an important strategy to improve the efficiency, quality, accountability and flexibility of councils’ (Burke and Walsh 1998, p. 92). The legislation required all local government authorities (LGAs) to competitively tender an increasing proportion of expenses, peaking at 50 per cent in 1996–97 and estimated to by then be worth $A1.5 billion (CTC Newsletter 1995). Importantly, these were legislated minima and it was envisaged that many LGAs would exceed them because, unlike their UK counterparts, they had discretion over which services and functions would be subject to competitive tendering. Hence while LGAs had no choice over whether they would engage in contracting, they retained some discretion over which services would be exposed to competition, and how these would be packaged for market.

In conjunction with CCT, a range of other reforms were enacted in the quest to transform local government. This included a programme of forced amalgamations, reducing the number of LGAs from 210 to 78 during the period 1993–95, the removal of all LGA councils and their replacement with government-appointed Commissioners, and the opening of all Chief Executive positions and their replacement with Cabinet approved personnel (Kiss 1999). As the new LGAs formed, they experienced significant fiscal stress when the state government unilaterally reduced municipal property rates by 18 per cent and imposed a three-year ban on increases. Importantly, democratically elected councils were not reinstated until 1997 in most cases meaning that local political parties and elected representatives had no influence over tendering during the first three years of CCT.

The purpose of this study was to examine this local government contracting process in practice. We undertook five complex case studies at Victorian LGAs, using the organization as the unit of analysis and considering several foci within it, and drawing on a range of data sources – interviews and documentation analysis for example – to allow space for competing views to surface (D. Kelly 1999). Case analysis is considered an especially powerful methodology when examining complex phenomena in situ (Stake 1994; Yin 1994; Berg 1998; D. Kelly 1999). Cases are chosen ‘because it is believed that [this] will lead to better understanding, perhaps better theorizing, about a still larger collection of cases’ (Stake 1994, p. 237). Hence, LGAs were selected for this study to provide balance, variety and a means of advancing understanding. This involved targeted selection, as opposed to random sampling, of LGAs based on their size and geographical location (Eisenhardt 1989; Stake 1994; Berg 1998). After initial contact with the LGAs, five agreed to participate in the study (pseudonyms were used to protect confidentiality): The Village (small rural LGA), Provincial (large rural), Suburbia (outer suburban), Cosmopolitan
(inner city) and The City (metropolitan). Given the focus here on initial contracting experiences, descriptive information on each LGA at the start of the CCT regime is provided in the Appendix.

Semi-structured interviews took place at five LGAs, two private sector firms, and with the local government union. Interviews typically lasted one hour and 21 of the 30 interviews were taped and fully transcribed for analysis – meeting notes were made where permission to tape record was refused. Given that the CCT regime was in place for a limited time in Victoria (1994–99), participants were asked to reflect on their experience of CCT, so that the interviews covered a range of issues and themes which structured our case studies. In addition, documentation was collected at the LGAs to provide information on aspects such as CCT policy, competition policy, organizational structure, finances, tender specifications, human resources, and organizational strategy. Publicly available information such as annual reports, government reports, submissions, and speeches also informed the case studies. The sections that follow report our findings in relation to the separation of purchasers and providers and the specification of services.

THE CHALLENGE OF PURCHASER-PROVIDER SEPARATION

A telling fact from this study is that none of the five councils were able to achieve what might be considered a ‘pure’ separation of purchasing from provision. This was the case regardless of whether senior managers were pro-reform or reluctant to separate. Our findings showed that to varying degrees, each LGA either left some of their service-delivery activities connected to policy and purchasing functions, or subjected those activities they did split to governance mechanisms which mitigated the extent of actual separation.

Three councils – Cosmopolitan, Provincial and The Village – instituted functional separations which amounted in practice to only limited uncoupling of purchasing from provision. Typically these entailed the adoption of ‘two-hatted’ approaches – that is, where a single staff member carried out duties on both the purchaser and provider sides of the organization. Within each LGA, the level in the hierarchy at which the line of separation was drawn varied between different services, creating a ‘wavy line’ of separation. Figure 2 sets out an example from Provincial which is discussed further below. Furthermore, the level of the line of separation shifted over time, as LGAs wrestled with the complexities

![Figure 2: Provincial’s wavy line approach to separation](image-url)
of implementing the purchaser-provider split. It has been noted that wavy line models often develop where separation occurs at different managerial levels within a single organization leading to a co-existence of purchasers and providers within the same operational group (Teicher and Van Gramberg 2002) and that these models commonly incorporate two-hatted approaches (Ernst 1996).

While the three cases in this group exhibited similar tendencies, each case was unique in its experience. For example, at Provincial, there was an explicit attempt not to separate the organization into purchasers and providers, despite considerable state government pressure, and they opted for what they termed a ‘probit split’. In practice they had instituted a wavy line model of separation, with the level of the split varying across the three branches (that is, services, planning and corporate). As figure 2 illustrates, most staff in the services branch were on the provider side of the organization due to the large amount of tendering in this area; around half of the planning branch sat on the provider side; and there were few providers in the corporate branch as tendering had been limited. In this council it was fairly common for branch managers to take on both purchaser and provider roles. For example, the services branch manager directly managed internal provider units and also chaired the tender evaluation panel.

In contrast, Cosmopolitan established a separate division (‘Cosmopolitan Enterprises’) which brought together all internal providers and engaged in the day-to-day management of these units. The medium-term aim (that is, post the first round of tendering), was to legally separate Cosmopolitan Enterprises and shift all (or any) successful internal bidders to this company. When tendering commenced, an internal agreement was struck between each provider unit (for example, street sweeping) and the appropriate section of the Services Division (for example, physical services), and this is where the (quasi) contractual relationship existed between purchaser and provider. The level of the split changed over time, creating a wavy line of separation. For example, when engineering services were tendered, the manager of Physical Services, who normally operated on the purchaser side – monitoring internal and external providers – switched to the provider side for a short time to prepare the internal bid. The Community Services manager also shifted (permanently) from the purchaser to the provider side over time. Despite claims of a very clean and clear separation, it was apparent at Cosmopolitan that the practice of separation was quite dynamic and that a wavy line emerged over time.

At The Village, the difficulty of separation was exacerbated by its small size and the turnover of Chief Executives during the initial reform phase. A wavy line and two-hatted approach was adopted here also, with managers taking on both purchaser and provider roles. For example, the Works Engineer was formally on the purchaser-side of the LGA when tendering began, yet shifted to the provider side of the organization over time. Despite formal allocation to one side of the split, in practice he carried out both purchaser and provider roles: ‘I now work strictly on the provider side, but it still crosses over … because we are too small’ (Works Engineer, The Village).

The other LGAs – The City and Suburbia – had senior management teams seeking to use reforms to transform their organizations and thus went much further in attempting to separate. However, even these LGAs encountered difficulties. The City adopted what we refer to as an external corporatist model, establishing a legally separate service delivery subsidiary (‘SubCo’). The aim was to transfer all successful internal bidders to this subsidiary and to bid for work at other councils and in the private sector. SubCo ostensibly had an arm’s length relationship with The City governed by commercial contracts,
which at first glance appeared to be a thorough institution of the purchaser-provider model. However, closer inspection showed that even this pro-reform LGA could not enact a clean separation. Internal business units had to be established because two groups of internal bidders – property valuers and community services – did not fit the manual services profile of SubCo. This created a less clinical separation than the senior management team had sought. Other aspects of the relationship between the parent and subsidiary also blurred this seemingly clinical split: The City provided safeguards over employee entitlements for staff who had been transferred to the subsidiary, and SubCo was obliged to purchase central services such as payroll from The City for its first year of operation.

Suburbia also adopted a corporatist approach to separation, but it was an ‘internal’ corporatization, since it did not legally separate in the same way as The City. Instead, it set up a series of internal business units along the lines of wholly owned subsidiaries, and all activities outside the corporate management group were transferred to these units (see figure 3). Its Chief Executive also adopted the language of a private sector CEO, referring to ratepayers as shareholders and councillors (when reinstated) as owners of the LGA.

On the surface, this appeared to be a very clear and high level separation of purchasers and providers, but closer inspection showed that complete uncoupling was not achieved. The internal business unit Boards, formally positioned on the provider side of the organization, demonstrated this point. Each Board was comprised of purchaser-side personnel: the CEO, two councillors (when reinstated), and two corporate directors. Over time, Board members became embroiled in day-to-day operational issues which were supposed the domain of purchaser units. This strayed considerably from their formal roles as Board members who were supposed to provide expert advice.

In the course of the study we identified several factors to account for the incompleteness of separation across the case study LGAs. The first was their experience in the amalgamation process which immediately preceded the introduction of CCT. The three LGAs we identified as adopting a ‘wavy line’ model all experienced major mergers, complex changes and high levels of organizational turbulence in the amalgamation process. Bedding down these changes was a challenging process encompassing merging organization structures, valuing assets, standardizing procedures, harmonizing employment conditions, and rationalizing IT and other systems – which was not complete by the time they were required to implement the CCT regime. This was exacerbated by a state government-imposed rate reduction, placing considerable financial pressure on the new LGAs. By contrast, the corporatist LGAs had undergone minor boundary changes which left more space to conceptualize and implement their separation models. Indeed, The

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FIGURE 3 The purchaser-provider separation model adopted at Suburbia
City was shifting toward such a model pre-CCT, as part of its push to modernize its managerial approach.

A second important factor was the position adopted by senior management teams. At The City and Suburbia, senior managers, driven by and responsive to their government-imposed Commissioners, were enthusiastic about the introduction of CCT – Ernst and Glanville (1994) referred to such management teams as zealots and converts as they were highly enthusiastic and true believers in the transformational power of such reforms. By contrast, at the other three councils, senior managers were less committed to reform. The Village had three different CEOs in short succession, each with differing attitudes, the net effect of which was a variable stance towards CCT. Cosmopolitan started with a commitment to corporatizing service-delivery functions, but this was abandoned when democratically elected councillors returned. At Provincial, senior management was more sceptical of the benefits of separation from the outset and instead remained committed, rhetorically at least, to a more unitary structure. In Ernst and Glanville’s (1994) language, such management teams would be termed sceptics and fatalists since they were either reluctant to participate in reforms or sceptical of the claimed benefits.

The analysis so far provides some explanation for why The City and Suburbia went much further in uncoupling purchasers and providers: they had less turbulent amalgamation experiences and more enthusiastic pro-reform senior management teams compared to the other three LGAs. However, it does not account for the fact that these two councils, despite these factors, were unable to enact complete separation. One would assume that, untroubled by the merger process, and driven by leadership teams zealous about reform, these councils would have ended up as paragons of contractualism. However, each displayed aspects which departed from a pure purchaser-provider model as articulated by government contracting proponents.

What this tells us is that separation is more difficult than proponents suggest, and more challenging than even critics have acknowledged. Despite the enthusiastic embrace of the contractualist model by The City and Suburbia, and their propitious post-merger circumstances, they were unable to apply the model in full in their organizations. Evidence from the five councils indicates five further problems, outlined below, that account for this.

First, attempts at separation led to a fragmentation of relationships within the LGAs. The splitting of previously unitary organizations tended to engender an ‘us and them’ mentality between purchasers and providers:

all of a sudden people that you would be networking with in a normal position … played their cards close to their chest even within the organization. ‘I’m not telling you because you are on the client [purchaser] side and I am on the provider side’.
(Shop Steward, Cosmopolitan)

The issue here was much more than simply drawing a line and creating organizational distance between purchasers and providers. This distance was aggravated by the perceived inequality in power, status and vulnerability between the two groups – all corollaries of the fact that separation had assigned them different roles. The power differential stemmed from the fact that the purchaser side would have the authority to choose providers and to allocate money. By contrast, providers faced a less certain future. This in turn affected felt status. A manager at Cosmopolitan stated that provider-side employees felt like ‘second class citizens’ because the split had ‘created a bit of a hierarchy where the clients are smart planners and providers plod away’ (Community Services Unit Manager, Cosmopolitan).
Fear of fragmentation attenuated the structural separations adopted. Thus, Provincial’s blurry separation was strongly driven by its desire to maintain organizational unity:

Splitting creates a dysfunctional organization. You have people trying to screw each other and you lose sight of the vision and mission of the organization... I don’t know how you can work as a coherent unified organization. (Service Branch Manager, Provincial)

Even at Suburbia, a desire to avoid fragmentation and the development of an ‘us and them’ mentality was cited as the rationale for their separation approach which entailed a relatively high level split. The Corporate Development manager argued, for example, that there was considerable fear that a lower level separation would heighten animosity between those on the purchaser and provider sides.

The second additional factor was the impact separation had on external relationships. For example, at The Village, it was argued that splitting the organization had fractured previously harmonious relations between employees, management and the community in the small rural municipality. At Cosmopolitan, it was argued that separation created confusion:

we had people with similar sorts of names but different responsibilities and I suppose for the community to relate to us as an organization, they just didn’t know who to call ... it was very confusing. (Community Services Unit Manager, Cosmopolitan)

Third, separation was more difficult for smaller organizations because it necessitated duplication of managerial ranks. This was clearly evident at The Village, where it was virtually impossible to split certain positions into purchaser and provider roles:

It was constantly raising a problem – because we are so small – by people being split, single positions being split because we couldn’t afford to have duplicate positions doing similar things – one for the client and one for the provider. So that was a constant problem. (Technical Services Manager, The Village)

In the case of Provincial, its commitment to a more unitary organization reflected, in part, a fear that a cleaner separation would lead to managerial duplication and increased costs. By contrast, The City had the scale and resources to establish a legally separate provider organization and put in place sophisticated contract management systems.

Fourth, separation diminished the opportunity for those engaged in service delivery to provide feedback to those who formulated policy, that is, purchasers. This was clearly evident at Suburbia, where it was cited as a core reason for its high-level separation. For example, it was argued that front-line staff played a critical policy role in Aged and Disability services and the separation of policy, client assessment and service provision would be detrimental to the organization and the community.

Finally, we identified a tendency for separation to replace former agency problems with new ones. While separation could clarify roles and responsibilities, the creation of distance between purchasers and providers often set up perverse incentives in the newly emerging contractual environment. This meant providers became more inclined to shirk their responsibilities or engage in gaming behaviour, armed with inside knowledge of how best to do this. A manager at Provincial expressed concern that separation would result in internal providers aiming for ‘...how to screw the client without the client knowing they are being screwed; how to screw the client at the same time as keeping the client happy’ (Service Branch Manager, Provincial).
THE CHALLENGES OF SERVICE SPECIFICATION

The specification of services is the second critical element of government contracting. Our research showed that all five LGAs found this problematic. Services had evolved over time and were largely governed by custom and practice, so that formalizing and documenting them presented a major challenge. The results were often partial and imperfect. In many cases, services were under-specified, leaving out task elements which were tacitly understood by programme staff but not properly surfaced for consideration by the specification writers:

It was hard to define it, and it wasn’t defined well … they were really pathetic [specifications]…. We left a lot of things out, an incredible amount of performance indicators that were just assumed and never put in the specifications and if someone else had [won] the tender they could have provided a really very poor service. (Aged and Disability Unit Manager, Suburbia)

with the Parks and Gardens [service] we found a lot of things that didn’t get into the specification not because people didn’t want them there, they just forgot they did them. And I suppose in the back of their mind they knew it wasn’t the core part of their job, but they just did it because they had time to and they were left off. (Technical Services Manager, The Village)

This had significant consequences for the relative price-competitiveness of external and in-house bidders. External bidders would put forward bids costed in line with the less complete task contained in the specifications. By contrast, in-house teams adopted one of two alternative stances. In some cases, they took the whole task – including the tacit, unspecified elements – into account in their costings, with the result that their tender price was uncompetitive. In other cases they bid at a lower, competitive price, and consequently won the contract, but later found themselves working beyond the specifications in order to do the work at the standards to which they, and the community, were accustomed.

The orthodoxy in contracting is to try and specify services in terms of outputs, leaving the provider room to find ways to maximize efficiency or improve the service (Donahue 1989; Domberger 1998; Behn and Kant 1999). In line with several writers (for example, Jost et al. 1995; Deakin and Walsh 1996; Hodge 2000; Entwistle et al. 2002; Romzek and Johnston 2005), we found that specifications tended to focus on different aspects of the production chain or programme logic – that is, of the chain of elements from inputs to processes to outputs to outcomes.

we still have a lot to learn in terms of the output and standards. The Property Maintenance [specification] first time around was very thick and had an awful lot of process stuff in it…. (Strategic Planner, The City)

There wasn’t enough emphasis on outcomes … and that then has held us back … in terms of evaluating or assessing performance of contractors … When you get down to it there is not enough in there about what a quality service [is] … when you read them now you say, ‘What are the things about quality in here?’ and it is actually very hard to find things that are about quality. (Community Services Unit Manager, Cosmopolitan)

In the study reported here we identified four factors to account for difficulties in the specification process. The first was the time pressure, given the relatively short period
that LGAs had to identify, package and specify services. This was far more pronounced at those LGAs that had encountered considerable turbulence in their amalgamation process (for example, The Village, Cosmopolitan and Provincial). A lack of adequate time to prepare specifications not only resulted in deficient specifications, but also in the inability of internal bidders to engage fully in the tendering process:

There was [170 tenders] that went out in a very short time ... we lost some units that we shouldn’t have lost because of inadequate specifications. Not only this council, [but] across the state. There were mistakes made in the choices that we made but because of the mad rush to get those 170-odd tenders out [and] there was bound to be some tenders that weren’t specified adequately. (Works Unit Manager, Provincial)

The second factor related to managerial capabilities in contracting practice. In the initial phase, we identified a distinct lack of relevant managerial knowledge and skills to cope with contracting on the scale and scope experienced. Managers had traditionally been in charge of service delivery by internal staff and had limited experience with contracting processes or post-tendering contracting management.

While these two factors had important implications in the initial phases of government contracting, they represented implementation challenges rather than fundamental obstacles to service specification. In other words, they were difficulties that would most likely be addressed over time as managers gained skills, LGAs hired staff with contract management experience, and mistakes were recognized and rectified in the specifications. In addition to these factors, however, we identified two challenges that were structurally embedded in the contractualist model.

One was the fact that some services exhibited characteristics, such as uncertainty or complexity, which posed challenges to managerial efforts to specify them as outputs. Typically this applied to white collar or social services rather than physical services. An internal document at Provincial explained:

Whilst in theory, it should be possible to adequately specify all services including policy advice and advocacy, in practice it is difficult to specify and measure this sort of activity with any reasonable accuracy, and without investing disproportionate resources in contract administration.

This is consistent with what is already a commonplace of the literature on contracting: that purchasers can find it difficult to translate their service preferences into precise and meaningful specifications (for example, Donahue 1989; Jost et al. 1995; Deakin and Walsh 1996). In this study however, we unearthed a further layer of complexity beneath this difficulty: that purchasing decision makers may not even know their own service-preferences, much less be able to convert them into detailed specifications.

The problem with the development of the specification [was] identifying what we knew we were doing and then the unknowns, what we didn’t... that was one of the biggest difficulties with the contract, actually specifying the full scope because it was an unknown quantity. We couldn’t even tell you how many guideposts we replaced a year... to know how to resource it [because] we didn’t have the asset and collection systems. No-one ever worried about that.... Now it had to be clearly defined so we could actually analyse the bids that came in.... It was a nightmare. (Works Unit Manager, Provincial)

From the example above, it is possible that some cases could be explained by poor processes and systems. However, and more fundamentally, these problems were due to
information asymmetry between council managers who became purchasers and local government employees who became providers. In our study, we found that a critical obstacle to specification was the fact that the knowledge purchasers required to prepare specifications resided with employees who, in most cases, were themselves about to engage in a competitive bidding process. At the most basic level, therefore, purchasers were dependent on providers to prepare specifications, a point largely ignored in the existing literature. This is especially so in the initial contracting phase, and is dependent on employees being disposed to sharing detailed information about their day-to-day work in an environment where they had lost job security and where they may or may not be the successful bidders for the service. The shift toward a competitive government model meant that providers could become vulnerable if they gave away this critical information. Employee perceptions about how the release of this information would affect their competitiveness were paramount:

[In the] leisure tender, the experts were the providers. They were the ones actually managing it, and the client side was very reliant on the provider for the information to write the [specification]. But the provider was cagey about what they were telling them because they wanted to keep a competitive advantage in their bids. (Community Services Unit Manager, Cosmopolitan)

In this context, one of the crucial roles for purchaser-side personnel became developing strategies for convincing employees to impart their critical knowledge. Providing full information was commonly framed as an advantage for employees:

they were in some regards reluctant to say exactly how they did what they did, trying to keep trade secrets. But it was quite clearly explained that there is no point saying to us that you do it this way and it takes this long when, if we bid for it, and we put that in, we are going to lose money in the long-term. We need to know actually what it does take. If it is a two-hour job we need to know it is a two-hour job. It is no use saying you can do it in an hour and a half because long-term you have cost over-runs. (Works Unit Manager, Provincial)

These appeals, however, met with mixed success. In some cases, such as Technical Services in The Village, employees responded with open disclosure of information, whereas in others, such as Physical Services at Cosmopolitan and Business Operations at Provincial, they remained wary, and continued to provide less than complete information.

One possible explanation for these differential responses seemed to be the pre-existing level of trust between management and employees. For example, The Village seemed to have had a more collaborative relationship with its staff, whereas a ‘them and us’ attitude was more prevalent at Cosmopolitan and Provincial. In discussing the involvement of staff in this process, a union official noted that they ‘could not be expected to cooperate on pre-tendering work that put the council in breach of faith with workers’.

The combination of implementation challenges – time pressure and managerial deficiencies – coupled with more fundamental challenges, such as purchasers’ difficulty in translating service requirements into output terms and even in articulating preferences, meant that service specification was a far from exact science in practice. Inadequate specifications were an obvious outcome of these challenges. A portion of this could be addressed over time, but the more fundamental challenges call into question some of the assumptions government contracting advocates have taken for granted.
THE SEPARATION/SPECIFICATION DILEMMA

This finding raises a possible contradiction within the contractualist paradigm: to the extent that one of its elements – the separation of purchasing from provision – fragments relationships; it makes it more difficult to carry out another of its elements – the specification of services. Splitting the staff who perform purchasing from those who act as providers creates a degree of organizational distance between the two groups. One reason is that it realigns their respective interests. Previously it was a given that the in-house staff would be the service-providers, and hence alongside the managers’ responsibility to get the maximum or best quality service for at least cost was also an interest in ensuring the size and viability of the organizational unit to which they jointly belonged with the internal staff – not least as a way of ensuring the capacity to sustain good service delivery. Under competitive tendering, however, the managers/purchasers had no particular stake in who provided the service. Instead, their responsibility was to choose whichever provider would offer the best and/or cheapest service. In this context, service-delivery staff were likely to regard the managers who were soon to become purchasers warily.

Splitting also reinforces organizational distance between the two groups because they are likely to spend less time with each other and to interact less frequently, thereby diminishing the circumstances in which trust and shared identity are sustained. This meant that even where the pre-existing level of trust between management and staff was high, the separation of roles tended to vitiate that trust over time. Indeed, as management at The Village moved to adopt the role of purchaser, it began to engage in a more contentious dynamic with its staff over the service specifications:

What we did have was, in that process of getting information from staff about what they did and putting that into a specification, reviewing that and saying, ‘Well, we don’t want some of that stuff done’, and chopping it off. And we would go back to the staff and they would say, ‘No, you’ve left stuff off’, and we would say, ‘No, we meant to leave that off’. There was a bit of disagreement … when people thought that that stuff was needed and Council didn’t think it was needed. (Technical Services Manager, The Village)

At the same time, the over-riding requirement for councils to be seen to be acting with the utmost probity made it difficult for them to maintain the type of collaborative relationship which might build trust and thereby engender the sharing of information. There was a concern that if the purchasing units of councils were seen to have too ‘cosy’ a relationship with their in-house staff, external bidders for contracts would feel disadvantaged. External providers were only too ready to complain, and if necessary take legal action, if they felt that in-house staff were being given unduly favourable treatment in the tendering process.

Thus purchasers faced a dilemma: they were reliant on employees for information to prepare specifications, but separation had created a situation where there was clear divergence of interests and relationships were strained. This dilemma arose due to information asymmetries, but also because most services were being subjected to tendering for the first time under legislative direction from the state government. These findings provide a basis for questioning what has, to date, been an unexamined assumption of the contractualist model: that purchasers actually know what they want to buy. For many of the services examined in this study, purchasers were patently unable to crystallize their preferences because the knowledge they needed in order to do so resided in the heads of a separate group, a group who were developing competing interests post-separation.
DISCUSSION

The findings from this study add to our understanding of competitive tendering and contracting in three ways. Firstly, they lend empirical support to existing theoretical contributions about the relative difficulty of separating purchasers from providers, as well as highlighting factors contributing to that difficulty. While we acknowledge that there is an extensive literature on this topic, the bulk of it is theoretical in nature, with the exception of studies of the British NHS quasi-market experiments (Le Grand 1990, 1991; Le Grand and Barlett 1993; Robinson and Le Grand 1994; Le Grand 1999). In the extant literature, there is an assumption on the part of proponents that enacting separation is relatively unproblematic, an assumption shared by default by many of the critics. However, a few writers acknowledge at least theoretically that separation can be challenging (Alford and O’Neill 1994; Walsh 1995; Stewart 1996; Ernst and O’Toole 1999; Aulich 1999; Gallego 2000; Klijn 2002). Our research provides some empirical support for their claims, and in the process extends the empirical evidence on this issue beyond the case of the NHS. Moreover, we identify a range of factors to explain what prompts these difficulties. Some of these factors, such as previous organizational turbulence and lack of managerial zeal, were implementation problems which could be addressed over time. But others were more structurally inherent: fragmentation of relationships both internally and externally; a need for a minimum scale to allow separation; ruptured policy-implementation feedback loops; and the emergence of gaming behaviour between organizationally distanced actors.

Secondly, this study adds to the empirical evidence already available concerning the specification of services. That this process is difficult is already well established in the literature (Donahue 1989; Deakin and Walsh 1996; Smyth 1997; Behn and Kant 1999; Hodge 2000; Entwistle et al. 2002; Klijn 2002; Romsek and Johnston 2005). Our study reinforces these findings, uncovering particular ways in which specification is difficult and some of the responses of councils to them, such as sliding from output to process specifications, and over- or under-targeting. We also throw up some possible explanatory factors. For instance, it was clear that there were implementation challenges flowing from time pressure and a lack of managerial capabilities in the scale and scope of contracting being undertaken. This fits well with general arguments about the challenges of public sector reform and questions the time pressure applied by governments to introduce such systems. These findings could also form the basis for a range of managerial prescriptions (for example, training, hiring policies) intended to build capacity in the public sector in order to address these limitations (see also Erridge et al. 1999; Brown and Potoski 2003).

Thirdly, the study develops the idea of a separation/specification dilemma, and underpins it empirically with evidence from our cases. This idea challenges the tacit assumption of the government contracting model that purchasers necessarily know what they want from providers. When the three elements of competitive tendering—separation, service-specification and competition—are juxtaposed, this assumption is questionable. Attempts to separate purchasers and providers and the subjecting of providers to competition created incentive structures in government organizations which had the potential to reward providers for withholding information, including that required to prepare tender specifications. The competitive process itself and the increasing distance between purchasers and providers, creates new (and often competing) goals. Within this process new space opens up for opportunistic behaviour which may undermine the supposed benefits that government contracting has promised.
That separation was problematic in the context of Victorian local government is underscored by their experience subsequent to CCT. In 1999, a Labor government was elected which reviewed the efficacy of CCT and replaced it with a ‘Best Value’ programme, drawing on the previous experience of the British Labour government. To monitor this programme, the government established an independent Best Value Commission, which every year surveyed councils’ progress in implementing it and issued an annual report. In its first report, the Commission noted that:

From an organisational perspective, Best Value is reuniting councils by ‘deconstructing the client-provider split’; it is also seen as encouraging a culture of responsibility not blame … (Best Value Commission 2001, p. 6)

The following year it reported interview findings that ‘…there was almost universal agreement that [Best Value] had “enabled organisational reintegration following the purchaser-provider split of the CCT era” and some spoke of the way it allowed these splits to be “healed”’ (Best Value Commission 2002, p. 4). These reports suggest that the fragmentation of relationships lingered on after the initial period of government contracting under the CCT regime.

CONCLUSION

This paper has subjected the orthodoxy in contracting and competitive tendering to scrutiny, and found that it is not as coherent as it first appears. Not only does the purchaser-provider split, combined with competition, impart incentives to ex ante providers to withhold the information purchasers need in order to specify services, but it also undermines the main means by which purchasers might overcome that predilection to withhold information: the development or maintenance of trust between the two parties. This is certainly a problem to be addressed by governments or public sector organizations which are beginning the process of competitive tendering of services, since it is most salient at the point of transition from in-house provision. This transition is still occurring in many countries, not only in developing nations and those restructuring their public sectors after their emergence from former communist regimes, but also in some Western European countries, such as France and Germany, where ‘new public management’ has been slower to take root. Our findings may provide some cautionary notes to reformers in these countries.

They also have some relevance to those Anglo-American and Western European democracies which have already been through a contractualist phase and are now moving to more collaborative, network-based forms of governance. To the extent that government organizations must rely on partners – public, private or non-profit – to achieve their purposes, they also rely on the willingness of those partners to disclose relevant information. The greater the information-asymmetry between the partners, the more vulnerable is the government organization to opportunistic behaviour by the partner(s) holding the important information. Of course, collaborative approaches entail the fostering of trust between the parties, which serves to promote the sharing of information. But trust, while necessary for collaborative relationships, is also difficult to build and maintain in practice (Bardach 1998; Huxham and Vangen 2005). This means that it may well be useful for a public sector manager or organization seeking to pursue collaborative relationships with other organizations to identify where the requisite knowledge for the task resides, and take it into account in developing the partnership.
ACKNOWLEDGEMENT
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REFERENCES


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**APPENDIX**

**TABLE 1** Descriptive information on the case study organizations as at 30 June 1995

<table>
<thead>
<tr>
<th>Identifier</th>
<th>The Village</th>
<th>Provincial</th>
<th>Suburbia</th>
<th>Cosmopolitan</th>
<th>The city</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description</td>
<td>Small rural</td>
<td>Large rural</td>
<td>Outer suburban</td>
<td>Inner city</td>
<td>Metropolitan</td>
</tr>
<tr>
<td>Population</td>
<td>6,720</td>
<td>75,870</td>
<td>110,900</td>
<td>62,000</td>
<td>39,715</td>
</tr>
<tr>
<td>Area (sq. km)</td>
<td>6,635</td>
<td>374</td>
<td>114</td>
<td>20</td>
<td>36.5</td>
</tr>
<tr>
<td>Total expenses ($000)</td>
<td>$4,735</td>
<td>$39,659</td>
<td>$44,825</td>
<td>$43,263</td>
<td>$137,510</td>
</tr>
<tr>
<td>Rate revenue</td>
<td>$4,735</td>
<td>$39,659</td>
<td>$44,825</td>
<td>$43,263</td>
<td>$137,510</td>
</tr>
<tr>
<td>Assets ($000)</td>
<td>$11,589</td>
<td>$255,033</td>
<td>$285,751</td>
<td>$473,406</td>
<td>$1,639,250</td>
</tr>
<tr>
<td>Employees</td>
<td>143</td>
<td>741</td>
<td>499</td>
<td>725</td>
<td>1,237</td>
</tr>
<tr>
<td>Employee costs ($000)</td>
<td>$1,832</td>
<td>$18,154</td>
<td>$9,068</td>
<td>$21,549</td>
<td>$47,950</td>
</tr>
<tr>
<td>Competitive arrangements as a percentage of expenses</td>
<td>26.2</td>
<td>17.75</td>
<td>46.7</td>
<td>20.62</td>
<td>20.9</td>
</tr>
</tbody>
</table>

*Source*: LGA Annual Reports and Municipal Association of Victoria.

*Notes*: 1: 1995–96 figure; 2: 1995-96 figure used due to consolidation of rates by former municipalities; 3: General rates only; 4: Current and non-current assets; 5: Figures reflect actual count of employees including full-time, part-time, casual and temporary staff; 6: Comprises contracts with suppliers resulting from competitive processes, in-house agreements, contracts of in-house agreements approved by the Minister; 7: Effective full time staff; 8: 1997–98 figure.