MANAGING IT OUTSOURCING RELATIONSHIP IN THE PUBLIC ADMINISTRATION

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ABSTRACT

The outsourcing business in the public administration is increasing mostly in Europe through different contracting models and governance structures, where public entities and providers set up a market relationships regulated within public administration regulation frameworks.

This paper presents a qualitative study based on an Italian Region that has outsourced its Information Systems.

This study, at a very early stage, tries to contribute to the debate on Outsourcing in the Public Administration in Italy underlining the characteristics of outsourcing models and how outsourcing processes are governed.

KEY WORDS Outsourcing in Public Administration | outsourcing governance | IT outsourcing.

1. Introduction

Nowadays strategical change and research of flexibility seem to be obligatory objectives for public entities, due to the fact that they are conditioned by high turbulence and complexity (internal and external).

Last decade has been characterized by modernization processes from a managerial and organisational point of view (Rebora, 1999), this resulting in public entities (which are becoming more decentralised) being pushed to focus on outputs and service levels provided to end users. Public entities actually operate in a new competitive scenario which is (re)defined by deregulation and technology pervasiveness.
This change, supported by a deep acceleration due to regulations prodding, has led to a redefinition of internal trims and the adoption of new organisational models that focus on strengthening outsourcing strategies, gaining external competencies and functions, improving tools for performance evaluation and strategic control. The main objective is to maintain control capabilities on activities and processes that have been externalised to product and service providers.

The outsourcing business in the Public Administration is increasing mostly in Europe through different contracting models and governance structures, where public entities and providers set up a market relationships regulated within public administration regulation frameworks.

In Italy the first stage of outsourcing processes has been mainly about non-strategic functions or functions which are instrumental to the delivery of the standard PA activities. The main objective was cost reduction. Now the focus is moving from reducing costs to improving the performance of the organization, this resulting in the presence of strategic purposes when it comes to take decisions about outsourcing (Meneguzzo, 1990).

The main benefits for public entities can be summarized as follows:

• cost reduction and economies of scale due to better specialization of suppliers;
• engagement of continual service improvement activities;
• access to resources, knowledge and capabilities of other actors in the competitive context (suppliers, competitors, etc.);
• reduction of the level of bureaucracy and better flexibility of the whole organisation;
• focusing of investments on the resources, knowledge and skills that differentiate the organization;
• the possibility to get complex and real-time information about costs, quality and results;
• the possibility to tie service costs to the results defined in the contract;
• the possibility to develop benchmarks for public entities with the objective to get good suggestions for the future;

Outsourcing is becoming the tool to encourage and support changes in public entities by pointing them towards better and more efficient management options.

This study, at a very early stage, tries to contribute to the debate on outsourcing in the Public Administration in Italy underling how outsourcing processes are governed and if accounting and financial tools in use are able to support public entities in evaluating the effectiveness of outsourcing choices, the ongoing management, the control of outcomes and performances.
This paper presents a qualitative study based on an Italian Region that has outsourced its Information Systems. The objective is to understand which structural and relational structures allow to reach innovation and strategic development goals, and within which limits.

2. IT Outsourcing in the Italian Public Administration: Characteristics and models

Throughout the last years the public sector has shown a great interest for some contractual agreements as sources of flexibility in order to obtain the same functioning within the public companies like the private one. Types of decentralization have been analysed particularly from both the strategic point of view and the contractual one.

At the beginning of the eighty’s, particularly in the USA and in the UK, lively grows a trend of decentralization favouring first of all the privatization of the activities and services, instead of the externalization. In the case of privatization, considered as a strengthening of the private role both from the strategic and operative point of view, the public management renounces the choices of the services and the definition of the strategy. Types of externalization in strictu sensu, instead, are summarized as follow (Meneguzzo, 1990):

- contracting out, when a public or a private entrepreneurs manages services and/or activities;
- contracting in, when the management of the services is given to other public institutes;
- partnership, considered as a process of cooperation between public and private sector like in the case of the joint venture.

In Italy there are many outsourcing examples in the public sector, especially within the IT services.

In 1969 the Ministry of Finance began a project of full outsourcing; but after that It decided to internalise IT systems and to create Consip SpA. The Ministry decided to maintain a control over the integration and the cooperation between systems on the one hand, and the normative dynamic and the evolution of the stuff competences on the other. Consip became the main interface for all the technical problems and the new projects of the Ministry, assuring the integration of the systems.

Another example of outsourcing concerns the Ministry of Agriculture. In 1980 It gave to Auselda only a part of the information systems, and this experience developed in a full outsourcing in 1985 when it gave to Finsiel
the management of all systems, in order to obtain economies of scale and integration. In fact the Ministry managed a software complexity, due to a normative framework, which quickly developed, and to an administrative system decentralized on the territory.

Both the examples show, as many other cases (ACI, Alitalia), how the choice of partnership relations as consortium or public-private venture represented and represent nowadays a prevalent strategy. The easier management of the relation, in terms of free decisional processes, becomes an important factor of choice that affects strategies. Actually the trade-off works between the difficulty of the management of the relationships among the institutions, as the case of the contracting in, and the difficulty of governance of the private subjects, as the case of the contracting out, because of the incompleteness of the contracts and the lack of specific competences.

More, the difficulty to empower the skills and the inner competencies has driven to constitute private enterprises with public sharing, aiming to manage the outsourcing contracts.

The choice of these intermediate relations of collaboration between hierarchy and market, thanks to an exercise more or less direct of the governance of the relation, solves at the source a series of problems and bonds primarily tied to the responsibility on the collective systems, to the respect of the policy determined at different levels.

The public sector, moreover, prefers the choices of insourcing or contracting in order to avoid a loss of control. The risk to create a situation of almost a monopoly, with great players of the market is high. This case would increase the risks of a failure of the relation and rise of the switching costs.

In the private sector, on the contrary, the choices of internalization or adoption of intermediate relation as the joint venture are tied to the increase of the costs of transaction related to the selection of the supplier with high frequency of the use of the resources (Wildener, Selto, 1999), with high level of technological uncertainty and asset specificity (Robertson, Gatignon, 1998; Poppo, Zenger, 1998), with high risks of opportunism (Steensma, Corle, 2002). Other independent variables correlated to the outsourcing decisions include: the risk of failure negatively correlated to the probability of internalization (Steensma, Corle, 2002); the costs of monitoring, where the difficulty of growing measurement, referred to innovative factors, is positively linked to an inner governance (Robertson, Gatignon, 1998).

The need of more flexibility and the innovative high boosts, contrary to the typical rigidities of the public employment, drive to reconsider the util-
ity to operate through the different contractual agreements provided for the Public Administration, creating with the final supplier a market relation more daring but regulated within the public administrative services (Willetcocks, Currie, 1997). According with Meneguzzo, the competitive management «represents the solution that allows to give importance to the substantial contents of the service supply» (Meneguzzo, 1990).

Nevertheless, the trend to the outsourcing processes in strictu sensu and the lack of experience and managerial models consolidated for the PA, open to a series of research questions:

a. Which are the roles, the activities and the useful tools to manage the supply relation successfully?

b. How do the ruling factors drive on the governance of the outsourcing relations?

c. Which are the controlling measures available that can be considered as effective management tools of the outsourcing contracts?

The first problem is linked to the difficulty to detect appropriate technical and strategic skills and roles able to support the correct execution and monitoring of the contractual agreements. This scenario drives the public companies to reconsider the organizational and operative requirements in terms of process of coordination and integration between the different units, together with the needs of professional and technical retraining of people involved in the outsourcing process, in terms both of direction and execution of the contract.

The management of the decision process only represents the first stage of the outsourcing processes, which careful management guarantees their success only partially. But it is decisive to start up processes of continuous reassessment to estimate both the quantitative aspects (levels of service), and qualitative aspects (perception of the quality) of delivered services.

The crucial point becomes, so, to manage the complexity and the dynamism of the outsourcing processes through activities of codification and standardization of processes and measurement units, definition of the interfaces of communication, allocation of decision power, definition of the processes of penalties and rewards.

The second problem, linked generally to the re-definition of the limits of the public, concerns the ruling factors which reduce within the public companies the possibilities of management, typically linked to the contract, of the different outsourcing solutions.

The third problem concerns the economic and financial methods of management of the contract. These conditions assume a crucial role because they have to reconcile the need of respect of the agreed budget and the
need of more flexibility linked to the introduction of new technological solutions and changes of the service request. Moreover, the traditional account systems of the public companies, focused on the cash accounting, do not allow, ex ante, to estimate the convenience of the different proposals taking care of financial expenditures, and ex post to verify and evaluate the performance of the supplier.

In general, the effectiveness of the management of the outsourcing process needs weighed strategic choices and a consequent organizational development characterized by high level of integration and a consequent coordinated development of competencies. The adoption of the outsourcing models like the contracting out is linked to the capability of the public companies to reconvert their own purchase and management structures in order to avoid the growth of the costs of the transaction contracts, because of the distortion effects of the opportunism and the power (competencies) of the supplier of the outsourcing services. This development and change of course is not simple and quick in bureaucratic structures like those of the public sector. Often the reduction of the risk of the loss of control on the outsourcing contracts, and the removal from the real needs of the inner users, carries out through a path of inner growth and development of managerial competencies that is not trivial at all.

3. An exploratory case study

The empirical material on which this paper is built has been collected in an Italian Region. Two collecting methods has been utilised. The first one concerns the analysis of archival sources. Internal official documents have been analysed and data from bids. The second is based on semi-structured interviews. Interviews have been involved individuals, both strategic decision makers and people involved in operational activities, directly involved in outsourcing processes (both IT and financial side). Roughly 10 hours of interviews were carried out by the authors. For confidentiality reasons no more information on the buyers can be provided.

The nature of the research questions made the choice of the exploratory case study method the most appropriate (Eisenhardt, 1989, Yin, 1994), both to explore and to get a deeper understanding of particular issues. In addition to the intrinsic limitations of case study research, the study could be partially biased by the fact that we observed only customer side. As a consequence, further investigation on vendors can be useful to validate the existing findings.
Management service of the network infrastructures, hardware goods, ICT services systems used by the structures of the Region and ICT services offered by the authority itself, are the object analysed. Actually the Region has drawn up a contract in 2007 of about 9.000.000.000 euros given to a group of companies. The actual lead company on January 2004 won a competition which provided a contract of 5 years for the amount of 6.600.000.00 euros, amount extended to 9.600.00.00 because of a new re-modulation on June 2004. On June 2006 the Region resolved the former contract and gave again to the same company similar services for the amount of 4.800.000.00 euros until the end of December 2007.

The services in the procurement contract are:
1. institution of a on-site call centre/help desk;
2. network maintenance services, network development and security;
3. system integration, system development, system maintenance;
4. hardware maintenance and workstations maintenance;
5. monitoring, support and control of third parties contracts.

The collaboration with the external supplier is included in the strategies of the Region which has set up a developing process of the network verged to guarantee interoperable standards and software cooperation between computer systems of its own offices, distributed in the territory.

Other objective concerns the adjustment of the current structure of the network to changing needs and to the confidential nature of the information. The prospect is the migration towards the Public System Network and to guarantee, at the same time, of the continuity of the services offered and the greatest cohesion among Public Administrations in the region.

With this structure it is possible to realize a net of reliable interconnections which guarantees alternative paths among different offices.

The model adopted for the project guarantees a distributed environment in which all the authorities can interact between themselves, setting aside all the platforms used. The distributed system assures the integration and interoperable applications, safety mechanisms and the measurements of the quality of services, the access to applications from different devices.

The Region expects from the outsourcing relation first of all the raising of the levels of the services, the access to new competencies and skills, the improvement of the flexibility and support to the change. In order to gain these objectives the Region considers to maintain in house three main functions/competencies:
1. Design of solutions and definition of requirements;
2. Definition of models for semantic interoperability in service; 

4. Discussion

In the paper major focus has been concentrated on IT supply services for which is requested a particular level of integration between user and supplier for the complexity of the object of outsourcing. The IT services under analysis, in fact, are closely bound to core processes of analyzed organization, both inner and outer (dedicated to final user).

Given the analyzed case it is clear that turning to outsourcing is the result of a deep analysis of internal organization and of its possibilities compared to needs and resources, of a study of internal processes (we lack of a specification of their cost). Administration chose to concentrate its energies on arguments that are more critical for its life and for services offered to citizens as the definition of requirements and the design of services, definition of semantics, and management of information. This is essentially done to avoid loss of internal knowledge and professional skills, necessary also to the verification of the validity of the committed service and to avoid a dangerous subjection.

The concentration of resources on the main mission that constitutes the essence of the organizational structure and the external commitment of other activities and services must prove to be favourable, economically too, and can be accepted only if suitable selection procedures have been arranged in advance, as much as suitable contractual tools in which, as well as a detailed definition of the committed service, warranty controls for the level of the furniture and transparency on operational procedure should be forecast. Research highlighted, on the other hand, a substantial inconsistency between features of the object of the supply and tools of relationship management.

Empirical evidences derived from the explorative case show as management tools usually prompted by literature aren’t always consistently applied in the observed case.

Contract and technical measures detailing it revealed themselves as the main governance tool of the relation. Nevertheless is really on its features on the capability to reflect the real features of relation that we met the biggest differences in governance systems adopted in the private system. An approach is marked by a static management of the contract, and a regulation too restricted. This one tries to respect predefined levels of service, trying to increase sales proceeds through the management of a bigger
amount of activities, and on the other hand trying to avoid penalties, often left unpaid for lack of a continuous monitoring activity. This approach limits the capability for the supplier to understand the needs of the user and to translate them in dynamic and performing services.

Management of uncertainty and technology dynamics and business processes depends on a good contract rafting, on the definition of goals and management and control processes (Willcocks, Fitzgerald, 1994), on modalities of operational modalities review, but also on the capability to stimulate in itinere actions and reactions of counterpart towards common goals. In complex cases, in fact, as the one analyzed, a contract as governance tool results effective only if it is posed in a dynamic shape, that is able to comprehend internally incentive tools, of recurrent review, of possibility of review and improvement of needed services during the relationship, that are controlled from time to time, considering the whole development of the relationship itself.

The case shows as in environmental internal and external uncertainty situations, as if in the case of technology, contractual forms defined first by community policy and then by national policy represent an area of vulnerability from the point of view of governance. Risk is that a growing dissatisfaction of users both external and internal and a difference between the expectations on the quality of service and the quality of service actually given, a lack of incentives to improvement, a bureaucratic selection of needs, the missed updating of available services. To the law, in effect, is given the task to identify the most suitable solution for the management of services, and to give coherent and effective solutions in situations of certainty (Pini, 2005).

Again, accounting systems based on cash accounting impact negatively on outsourcing governance. They do not allow, ex ante, to evaluate the value of different proposals, focusing mostly on cash outflows, ex post to control and evaluate provider performances.

Putting the accent on the relevance of financial aspect of management disregarding the economic one (accrual accounting) doesn’t create the basis for accountability, that is making responsible on performance, of the right use of the resources, on the decisions to activate commercial partnerships, on the financial supportability of the desired services, to plan future investments (Tommasetti, 2008). It would be appropriate to use an analytical distribution of cost, that should consider the various stages in which is divided the life of the information system. A structure of cost isn’t present, in fact, articulated in supplied services or in activities, clearly linked to the use of a well determined factor. It seems impossible to follow
a recovery of efficiency for activities that present a contained added value and a recovery of flexibility in the management of costs. The single entries that make the cost of the service managed internally by administration should be related to the effects of externalization on the same costs in terms of savings, for economic convenience; evaluations at the same time should be done in political terms and considering the strategic direction of the administration, the features of product as well of the service, constraints tied to the resources allocation.

5. Conclusions

Outsourcing isn’t simply a commitment to an external supplier on activity phases of service delivery, but expresses a logic of redesigning and it’s supposed to focus on the main mission, defending some of the main activities e focusing the attention on the needs that tries to fulfill. It’s necessary to keep a power of continuous control on externalized processes, on quality of service, on planning, on development of services. It would be appropriate for public authorities to adopt control tools able to affect the behavior of outsourcer as budget, report, rules and procedures, dynamic contracts, relational trust. As for the relational aspects, administrations show an interest limited to management of relations of endowment as a kind of partnership. It’s an inheritance of a vision strongly tied to bureaucratic formalisms. Governance of social relations informally developed seems to determine success of outsourcing processes and of capability of innovation of organizations. Lack of recognition and management of these informal relations tends to under estimate the role of knowledge. A poor sharing of knowledge and information in the supply chain, could produce cost benefits for users and supplier in the short period. Risks of losing long time benefits deriving by the tight collaboration, nevertheless, are high. These considerations induce to deepen the explorative analysis of the relations between user and supplier, widening it also to the cases that weren’t studied in this paper, to build a complete outline of the current management practices. In particular, starting from the limitations of the research considered, next steps will be in the direction to widen the surveying on the field.
REFERENCES


