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Organisational leadership and decision-making: A study of the politics of public sector outsourcing

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Abstract

The increasing propensity for Australian public sector organisations (PSOs) to engage in outsourcing is promoted by public sector reforms and government policy which foreground outsourcing as a means for reducing costs. These reforms and policies are consistent with the theory of Transaction Cost Economics (TCE); the conventional, explanatory framework applied to outsourcing, which suggests that where the market is cheaper, outsourcing is preferred to in-house production or provision (insourcing). A broad-based, multiple methods study was conducted to investigate how and why outsourcing decisions are made by the managers of Australian PSOs and to examine the relevance of TCE as an explanatory framework. Emergent dimensions of the research highlighted that the basic cost reduction tenet of TCE is often overshadowed in practice because of intra-organisational politics within the leadership of organisations, as well as by external political pressures to comply with government policy or appeal to community stakeholders.

Keywords: outsourcing, politics, public sector, transaction cost economics, cost minimisation

I Introduction

The rapidly growing trend in outsourcing varied functions and services by the Australian public sector (APS) is promoted by government policy predicated on the basis of improving organisational efficiency, principally by reducing costs (CTC Research Team 1995; Walsh 1995; Barrett 1997; SCPAC 1997). However, ‘much of the literature associated with contracting out [outsourcing] is generalised and dominated by dogmatism and rhetoric’ (Lyon 1994, p.364). There is also the concern that ‘contracting has developed so quickly that it outstrips the capacity of government to monitor what is happening, and so learn from mistakes’ (Davis & Wood 1998, p.85). Consequently, until many of the claimed benefits and costs of outsourcing are studied, they remain anecdotal and perhaps illusory.

While the achievement of cost savings is the publicly touted rationale for outsourcing public sector services, the findings of the current research illustrate that politics has an important role to play in assisting to explain why the cost savings objective can be undermined in practice. As part of a broader research project that investigated the importance of costs in making outsourcing decisions in Australian PSOs, this paper reports the results and findings of the research concerning the largely hidden impact of politics on these decisions.

The paper commences with a brief review of the literature, including an overview of the conventional theory underlying outsourcing decisions. The research methods are then outlined, followed by discussion of the research results. The paper concludes with a summary of the findings of the study.

II. Literature review and theory development

The view that the market mechanism is an appropriate means for the delivery of public services is derived from the principles expounded by Adam Smith, Hayek, and other laissez-faire economists of the 19th and 20th centuries (Freebairn 1998; Guest 1998). This ‘public choice’ approach argues against overt government intervention in the functioning of markets and provision of goods and services to the public. The argument is also based on the belief that government bureaucracies offer little incentive for gaining or maintaining efficiencies compared to the market system, meaning that private sector organisations are able to outperform PSOs in producing more output for the same amount of inputs. Such greater productivity has been ascribed to the capacity of private firms to better monitor and provide incentives for workers and management (Alchian & Demsetz 1972; Vickers & Yarrow 1988), and thereby reduce dysfunctional behaviours.

2.1 Privatisation policy

Faced with the real or perceived need for fiscal restraint, and the notion that the private sector is by nature somehow more efficient, productive and cost effective, the competitive discipline of private sector corporations has been transplanted to the public sector. The emerging theory of public management means that ‘public managers have to shift their focus from observing procedures and rules to considering how their behaviour and decisions will increase the “pay-off” or “value for money” for corporate government’ (Koch 1996, p.33). Public sector decision making should thus be dominated by an economic rationalist approach (Self 1993) in line with this new management paradigm.

In essence, privatisation, or turning to the market, is probably the pivotal public sector reform of the last 20 to 30 years and, of all privatisation alternatives, outsourcing is the one most frequently considered (Ferris 1986). In terms of public sector outsourcing internationally, the pre-eminent rationale is to obtain ‘value for money’ and economise on costs (see, for example, McDavid 1985; Ferris & Graddy 1986; Touche Ross & Co. 1987; Domberger, Hall & Jeffries 1995; Walsh 1995; Industry Commission 1996). Even in the private sector, cost savings are generally the prime, key performance indicator of the success of outsourcing (O’Shea 2000, p.39). The cost savings objective is accorded predominance in Australian government policy on contracting out (see Hilmer Report 1993; *Commonwealth Policy Reform Act 1995*; DOFA 1996; SCPAC 1997; Fahey 2000) and is recognised by public sector industry bodies as the overarching consideration in outsourcing (see ICMA 1989; Boyd 1994). Thus, government policy and legislation, as well as the rhetoric concerning the privatisation, restructuring and outsourcing debate, remains firmly founded on the cost savings and cost-efficiency issue (Forster 1993).

2.2 Modelling decision-making

Economic rationalism, derived from Transaction Cost Economics (TCE), presupposes a particular, bounded rational, model of decision making. The bounded rationality model of choice suggests that rather than being maximisers, decision-makers are satisficers who choose the best alternative within the limits of practicality and cognitive boundaries (Simon 1955). While bounded rationality offers a seemingly valid explanation of decision-making, it fails to recognise that in the PSO context outsourcing decisions may inevitably contain political dimensions.

The political model of choice (see, Pfeffer 1981) may, therefore, be more relevant. This model holds that decision-making is characterised by a lack of formalised, set goals, by conflict and use of power in reaching decisions, by the building of coalitions and alliances, and by compromise. Choice thus becomes dependent upon persuasion and bargaining and on the power wielded by individuals or groups of individuals acting self-interestedly. Under such a decision model, criteria for decision making might be used selectively and information withheld.

The key implications of this model are that organisations can be viewed as political systems; that decisions are the preferences of powerful members within the organisation and that people will engage in observable, but often covert actions to enhance their power to influence a decision (Eisenhardt & Zbaracki 1992, pp.23-26). A contextual interpretation of this model means that external political influences and government policy aside, there is also potential for internal organisational politics to affect outsourcing decisions. Such influences are likely since outsourcing involves a resource allocation decision. These decisions are ‘a major area of organizational politics because control over resource allocation is a major exercise of power which can be directed toward gaining strategic advantage inside the organization’ (Byrd & Moore, 1982, p.181).

2.3 Theoretical foundations of outsourcing decisions

The conventional theoretical foundation of outsourcing decision making is TCE and its parent framework, agency theory¹ (Jensen 1983; Ferris & Graddy 1991). At the most basic level, accountability concepts used in the context of the public sector derive directly from the principal-agent framework. In promoting the best interests of the government and the public, a monitoring and accountability regimen is established to ‘ensure that civil servants will deliver cost-effective programmes’ (Lapsley, Llewellyn & Mitchell 1994, p.39). The agency theory framework can be extended to explain the higher costs of public bureaucracies compared to the private sector by viewing public sector managers and bureaucrats as agents, and elected officials (eg. councillors, ministers) as principals. The presumption is that bureaucrats (agents) have an informational advantage over principals, through superior knowledge of production costs. In other words, information asymmetry exists and together with the lack of property rights to residuals (ie. the difference between budgeted and actual costs), there are reduced incentives for bureaucrats to minimise costs while incentives to create budget slack are increased (Ferris & Graddy 1991).

Davis and Wood (1998) suggested that one response to the control of opportunistic agents (public servants) seeking to capture organisations to further their own agendas is to introduce contracting by opening up internal operations to tendering and competition. This may have the effect of constraining public sector managers from overcharging the 'owners', thereby keeping costs down.

TCE assumes that the minimisation of cost is the basic rationale for choosing either a hierarchical organisational structure (insourcing), or for relying on the market mechanism (outsourcing) (Williamson 1973, 1985, 1996). The theory supports both the notions of cost economisation and bounded rational decision making. In addition to considering a range of transactional factors, such as asset specificity, frequency, uncertainty and the competitiveness of markets, TCE predicts the use of markets (outsourcing) in preference to hierarchies (insourcing) for minimising production and transaction costs when goal incongruence is high and possibilities for opportunistic behaviour are low.

While the TCE framework is the standard theoretical justification for outsourcing, developed largely by reference to and research in the private sector, its relevance to the public sector has been inadequately explored (for exceptions see Ferris & Graddy 1991; Kavanagh & Parker 2000; Lane 2001). Forster (1993) holds that it is not possible to transfer TCE and its *raison d'être* to PSOs. PSOs are structured differently to private sector organisations, operate in different environmental contexts, must provide some services for redistributive and equity objectives or social good rather than for profit-making, and some have a core of services (eg. judicial, policy, immigration, policing) which are not appropriate for full-scale outsourcing regardless of cost concerns.

In the public sector setting, parent organisations, such as governing boards and parliament, have powerful roles in shaping the organisation, as have external constituents including political pressure groups and volunteer oversight agencies (Wright, Kroll and Parnell 1996, p.291). Such structure distinguishes PSOs from their private sector counterparts and makes the public accountability contingency (Donaldson 1995) a key variable. As Barrett (1997, p.31) submitted:

public sector agencies have to satisfy a complex range of political, economic and social objectives and operate according to a very different set of external constraints and influences. They are subject to expectations and accountability from their various stakeholders, who are more diverse and more contradictory in their demands than those of a private corporation.

Research was undertaken to assess how and why outsourcing decisions are made in Australian PSOs and was prompted by the failure of the theoretical literature to address the distinctiveness of the PSO context.

III Research methods

The study reported in the current paper was conducted between 1998 and 2001. While a range of variables potentially useful in explaining outsourcing decision-making was examined, the current paper reports on the largely unanticipated and emergent findings related to internal organisational politics and external political pressures.

Three complementary phases of research were undertaken, comprising a case study of a PSO, a program of convergent depth interviews with managers from fifteen other PSOs, and a large-scale survey questionnaire administered to managers of a further 131 PSOs. Outsourcing decision-making practices were investigated in PSOs operating at all levels of government and across all States and Territories. This multiple method research design was chosen as having the best potential for capturing complex, comprehensive and cross-sectional data. While only a single, in-depth case study was conducted, the key outsourcing decision-making themes and issues identified in that study were replicated through the program of depth interviews. The survey questionnaire, strongly focused on the main theoretical and practical outsourcing issues, was then administered to a broader sample of managers.

3.1 Case study

The case study concerned a self-funded, regional PSO operating in the leisure/recreation industry. The PSO was relatively small, employing less than 100 people, inclusive of casual staff, with an annual budget under \$7 million. The organisation's two prime and often conflicting objectives included an environmental preservation component and a self-funding, service provision mandate.

Twelve managers and staff of the PSO were individually interviewed and several other personnel were interviewed in groups. Interviewees were both information evaluators (finance staff and finance managers) and decision makers (executive and middle managers). Thirteen outsourcing activities of the organisation were examined and the interview data collected were corroborated by review of documents, including outsourcing contracts, service level

agreements, annual reports and internal accounting reports, as well as by observations of staff discussions and meetings.

3.2 Program of depth interviews

In the subsequent depth interview program, managers from fifteen other PSOs were selected using a maximum variation strategy to produce a heterogenous sample of participants and organisations. The interview sample included five key informants from each of three main PSO types. The three PSO types studied were local governments, budget-funded organisations, and self-funded organisations,² consistent with accepted categories of PSOs (see O’Faircheallaigh, Wanna & Weller 1999). The sample was, however, biased in favour of organisations located in New South Wales (NSW) (80%). These details are summarised in *Table 1* below.

Table 1
Depth interviewee and organisation characteristics

Organisation type	ID	Manager’s position	Industry	State/Territory	Govt. level
Local govt organisations	LG1	Finance Officer	Local government	NSW (regional)	Local
	LG2	General Manager	Local government	NSW (regional)	Local
	LG3	Corporate Services Director	Local government	VIC (metro)	Local
	LG4	Planner	Local government	NSW (regional)	Local
	LG5	Finance Manager	Local government	NSW (metro)	Local
Self-funded organisations	SF1	Finance Manager	Electricity/Power	NSW (both)	State
	SF2	Business Manager	Tourism	NSW (regional)	State
	SF3	Manager	Conservation	NSW (regional)	State
	SF4	Director	Leisure/Recreation	NSW (metro)	State
	SF5	General Manager	Tourism	NSW (regional)	State
Budget-funded organisations	BF1	Director	Higher education	NSW (regional)	Ctw.
	BF2	CEO	Health	NSW (metro)	State
	BF3	Finance Manager	Health	NSW (regional)	State
	BF4	Purchasing Director	Justice/Corrections	QLD (metro)	State
	BF5	Accountant	Heritage/Culture	ACT (metro)	Ctw.

3.3 Survey questionnaire

Following the program of depth interviews, a survey sample was drawn from the entire population of Australian PSOs and from populations of each of the three PSO types, using print-based and on-line government directories. A total of 675 organisations were randomly selected, including 225 organisations for each of the three major types.

The survey instrument was pilot tested on a sample of 21 respondents and was post-tested using a range of reliability and validity analyses, including factor analysis and calculation of

Cronbach's alpha coefficients, producing useable data sets with acceptable to very good levels of reliability.

Questionnaires were distributed via post and email and two rounds of follow up were conducted. In total, 138 responses were received from organisational leaders such as CEOs, CFOs, Corporate Services Managers and Competition/Contracts Managers, constituting a response rate of 22%.³ Seven responses were unusable, and of the remaining 131 responses, 15 were from organisations not engaged in outsourcing activities. Useable response rates for sub-samples were:

- local government organisations, 29.1% ($n = 64$)
- self-funded organisations, 19.1% ($n = 36$)
- budget-funded organisations, 16.6% ($n = 31$)

Since response rates were far from ideal, two tests, the surrogate method (Oppenheim 1966) and assessment of validity of responses compared to the population, were applied to assess the level of non-response bias according to organisation size, State/Territory and level of government. Tests revealed a lack of significant non-response bias in all sub-samples and in the overall sample.

IV Results and findings

The results and findings of the research relating to internal politics and external political pressures from governments, constituents and communities, and the effects of these variables on the process of outsourcing decision making, are discussed in the following sections of the paper.

4.1 Intra-organisational politics

The analysis of case study data revealed that politics played the primary role in outsourcing decision deliberations in the PSO concerned.

Several government appointees to the organisation's Board represented environmental interest groups and some staff positions were also concerned with the environmental impact of the organisation's activities, particularly its outsourcing activities. Several managers noted that the task of seeking to reduce costs through outsourcing was often made difficult because of the strong pro-environmental attitudes of many Board members and managers. These attitudes were countered by another smaller 'faction' of the Board that viewed activities such as

outsourcing, not so much as financially sound options, but as means for demonstrating 'efficiency' to the Minister. Interviewees alluded to instances of strong clashes between Board members, and between Board members and managers, creating tension and animosity at meetings. Trade-offs and compromises in decision making appeared difficult to achieve and usually environmental interests won out.

The dominance of environmental interests was reinforced by examination of the PSO's organisation chart which evidenced the isolation of the Commercial Development function from other functional areas, especially from the Environmental function, and also highlighted the significance of the Environmental function at Executive Management level. Participants revealed that these relationships existed because of various power and political tensions between organisational actors.

Politics; internal, external, and party-based, proved to be the most important variable affecting the case organisation's management and operations related to outsourcing.

During interviews questions concerning managers' personal party political preferences were not asked, however, in nearly all instances the participants volunteered information about these preferences. One manager, who was unhappy at the time with the politics in the organisation, stated that 'government business units need to run as a business, not as a wing of any given political party'. There was strong evidence of tension between managers resulting from their personal party political views and the influence of these views on how they regarded both the philosophy and practice of outsourcing. For all but one of the managers interviewed, attitudes toward outsourcing appeared to be coloured by party political affiliations. Those with acknowledged Labor, Democrats or Greens preferences generally had negative attitudes toward outsourcing, while those with Liberal-National party preferences had positive attitudes.

Despite the differences in attitudes toward outsourcing, none of the managers, regardless of whether their attitudes were positive or negative, actually behaved in a manner consistent with their espoused claims that costs were of chief importance in outsourcing decision-making. The group with Labour/Democrats/Greens preferences appeared to be concerned about 'keeping the Minister happy', making a contribution to local employment, and ensuring that ecological and environmental concerns were addressed, and saw outsourcing only as a last resort to achieve these ends. While managers with opposing political views generally had

more commercially-focused outlooks, they too seemed to behave as though costs were relatively unimportant in outsourcing decision making, although for quite different reasons. This group of managers tended to view outsourcing as a means for eradicating organisational ‘problem areas’, be they staff or services, reducing the workforce (especially in the organisation’s off-season), and decreasing labour union power. Such political factors, internal to the organisation and its leadership, as well as external political pressure, were most influential in determining the outcome of outsourcing decisions in this PSO, as summarised in *Table 2*.

Table 2
Factors important in outsourcing decisions – Case study

Factors	Promoted Outsourcing	Discouraged Outsourcing	Importance Weighting
Internal politics: <i>{Risk-related factors</i> <i>{Environmental impact & issues</i>		✓	High
External politics: <i>{Good ‘appearances’</i> <i>{Improved real or perceived accountability</i>	✓		Moderate
Cost & financial factors		✓	Moderate
Contractor factors: Isolation & dependence on contractor		✓	Moderate
Staff-related factors: Loss of expertise & in-house knowledge		✓	Moderate
<i>Labour union difficulties</i>	✓		Low
Need for staffing flexibility – seasonality	✓		Low
Convenience factors – ease, routine task/s	✓		Low
Fraud, corruption & probity factors		✓	Low

As displayed in *Table 2*, risk related and environmental factors have been ranked topmost among the ‘political factors’ impacting outsourcing decisions in the case PSO. While such factors would not appear to be overtly political in nature, arguments based on risk and environmental impact, however insignificant such issues may have been, provided a basis for the dominant decision-makers to legitimise and rationalise their personal views, biases and party political preferences. As part of staff-related factors, desires to reduce labour union difficulties were also politically motivated. Taken collectively, the factors described in *Table 2* also implicitly illustrate a lack of formalised goals and the variable criteria selectively applied in making outsourcing decisions. These factors highlight that the process of decision-making in the case PSO best accorded with a political model of choice.

The results of the depth interviews with managers from fifteen other PSOs provided further support for the relevance of the political model of decision-making. Most interviewees stressed how power, politics and bargaining were used within their organisations in making

outsourcing decisions and provided illustrations of the selective and variable nature of information searches and decision criteria.

4.2 Government politics

The strategy literature (see for example, Mintzberg & Waters 1985) suggests that sometimes organisations and their managers cannot pursue their own strategies because strategy is instead imposed upon them by external individuals or groups. Both the case study and depth interview research served to illuminate the affects of external political influences on outsourcing decision-making in Australian PSOs.

In the case PSO, the affect of external political pressures was felt by some of the organisation’s managers and reflected in their desires to ‘keep the minister happy’ or demonstrate ‘efficiency to the minister’ (see *Table 2*). In the multi-organisation depth interview sample, several managers stressed that outsourcing often occurred only because of government imposed or legislative requirements to do so. The managers expressed needs to ‘toe the line’ and have an opinion which ‘depends on the government of the day’ (BF4), outsource according to ‘the flavour of the month’ (BF3), and ‘satisfy CCT legislation’⁴ (LG3). These views clearly point to external political concerns shaping outsourcing decisions.

Table 3 provides a breakdown and ranking of the factors involved in outsourcing decisions according to the managers from the fifteen PSOs comprising the depth interview sample.

Table 3
Factors important in outsourcing decisions – Depth interview sample

Factor grouping	Promoted Outsourcing (Ranking)	Discouraged Outsourcing (Ranking)
Staffing & labour-related factors	1	4
Cost & financial factors	2	2-3
Quality & customer-related factors	4	2-3
Contractor control & performance factors	5	1
Other factors	3	5

Table 3 shows that managers perceived that staffing and labour-related factors contributed most in deciding to outsource, while in deciding not to outsource contractor-related factors were the single most important factor. However, in each of the five factor groupings displayed in *Table 3*, political dimensions were apparent based on interviewee comments. Some *verbatim* examples of these comments include:

- ‘one other significant benefit [of outsourcing] is that you can avoid all of the restrictions and lack of flexibility that you have in the public sector because of labour union pressure’ (BF2);
- the major benefit of outsourcing is ‘transferring our problems onto someone else’ (BF5);
- the main advantage of outsourcing is ‘getting rid of your workers’ compensation problems’ (LG2);
- ‘the disadvantage [of outsourcing] is that it allows management to limit managerial responsibility’ (SF1);
- there is ‘a downside in contractors coming in from outside and taking away job opportunities for local people’ (LG2);
- since outsourcing ‘our labour relations with the existing staff that remain [have taken] a real downturn in productivity levels and just general feelings within the office’ (LG1);
- ‘we are bound to be competitively neutral’ (BF1); and,
- ‘the ACCC looks at competition policy and practice around the country ... it may be an issue that would come up’ for the organisation in making outsourcing decisions⁵ (BF2).

The survey questionnaire provided some reinforcement for these results. The 116 participants from organisations engaged in outsourcing were asked the open-ended question ‘why does your organisation outsource?’ While the modal response provided by 19.9% of respondents was cost reduction, only six (5%) respondents listed cost reduction as the sole reason for outsourcing. Slightly more than 18% of respondents cited the need to satisfy government outsourcing directives or statutory requirements as a reason for outsourcing, including ten (8.6%) who reported this to be the sole reason. Of respondents pointing to political directives as a motivator for outsourcing, 62% were from local governments, 28.5% from budget-funded organisations, and the remainder from self-funded organisations. Not surprisingly, most of the local government respondents concerned were from Victorian councils where compulsory competitive tendering is mandated through the *Local Government (Competitive Tendering Act) 1994* (Vic).

A 7-point Likert scale question stating that ‘for public sector organisations, outsourcing is necessary to satisfy government policy’ was employed to further test managers’ perceptions. Means for the overall sample and sub-samples indicated that managers agreed with the statement, although there were no significant differences in these responses based on organisation type. However, based on organisation size, a *t*-test was significant at the 0.01 level ($t = 2.623$), indicating that managers of large organisations were more likely than managers of small organisations⁶ to agree that outsourcing is necessary to satisfy government policy.

This result was supported by the previous analysis of responses to the open-ended question about reasons for outsourcing, given that 81% of respondents stating that their organisations

outsourced in order to comply with government policy or legislation were from large organisations, including three of the five largest organisations, with budgets in the \$0.5-\$1 billion range. The results for large versus small organisations might, therefore, be explained by the greater visibility, public awareness and government scrutiny of larger PSOs and the desires of managers of these organisations to be seen to be conforming to government policy and community expectations.

A further open-ended survey question provided respondents with the opportunity to 'list what you consider to be the major problems or disadvantages of outsourcing'. While only 24.4% of responses to the question were from managers of budget-funded organisations, their responses accounted for 57% of all responses citing politics, government policy and legislation as problems of outsourcing and these organisations were also among those with the largest budgets in the sample. Some *verbatim* remarks of these respondents include:

- 'once [outsourcing is] funded ... it is very difficult to defund, mainly because of political concerns' (*BF, Qld*);
- a problem of outsourcing is 'potential loss of political control' (*BF, NSW*); and,
- outsourcing 'is seen as more an initiative of government rather than for business reasons' (*BF, NSW*).

The final section of the survey questionnaire allowed respondents to provide 'any general comments you wish to make about outsourcing and/or costing in your employer organisation, or in the public sector in general'. Of the 53 respondents who chose to make comments, 15 (28%) discussed the political nature of outsourcing decisions within their organisations and the influence of government policies on organisational decision-making. A selection of *verbatim* comments from these respondents suggests that outsourcing decisions were perceived as:

- 'naïve and knee jerk reactions to government policy ... Ill-advised and poorly enacted' (*SF, NSW*);
- 'based on political whim' (*SF, NSW*),
- 'dependent to some extent on the policies of the government of the day' (*BF, Qld*);
- 'political in some areas' (*BF, Qld*);
- 'lost through compliance with legislation and process orientation – the process is more important than the outcome?' (*LG, Tas*);
- 'a matter of public service doctrine [which] has resulted in many absolute disasters' (*LG, WA*); and,
- 'politically driven and hence not viable' (*BF, WA*).

While such government-led political imperatives to outsource imposed boundaries on how some managers perceived the practice of outsourcing, and on how the organisational leadership made outsourcing decisions, other external political pressures were also apparent.

4.3 Local politics

Results from both the depth interview program and the survey illustrated a politically motivated divide between the propensity to outsource and the outsourcing practices of metropolitan versus rural and regional organisations, especially at the local government level. Rural and regional PSO managers perceived relative disadvantages in terms of availability, choice and cost of outsourcing contractors in comparison to their metropolitan counterparts, rated organisational adoption of outsourcing lower and had less positive personal attitudes toward outsourcing. Their concerns, as with those of rural local government managers forming part of the survey sample, were largely related to local employment and economic issues. The following interviewee comments are indicative:

- ‘In really small towns, outsourcing can’t happen ... outsourcing has a negative impact, local businesses suffer, and there’s a multiplier effect’ which further degrades regional economies (LG1); and,
- Outsourcing in ‘rural councils is quite different to metropolitan areas ... taking away job opportunities for local people’. Councils need to provide services themselves to ensure that ‘local businesses remain open’ (LG2).

Survey responses to the open-ended ‘problems of outsourcing’ and general ‘comments’ sections of the questionnaire were along similar lines, such that:

- ‘In rural towns, loss of labour and work to outside organisations affect viability of communities’ (LG, NSW);
- Outsourcing ‘destroys a small town if workforce (local) is reduced’ (LG, WA);
- ‘In a small, remote town there is often no competent third-parties to whom work can be outsourced. If we outsource further afield we destroy local employment and the town will die’ (LG, WA); and,
- ‘Contracting is an attempt to reduce wage rates and has major implications in rural Victoria when coupled with NCP’ (LG, Vic).

These interviewed and surveyed managers, taking a parochial view in seeking to support their local communities and economies by resisting outsourcing, were from organisations categorised as small, and the effect was the opposite to that on managers of large organisations who felt obliged to outsource as a result of government policy.

Supporting these results, Pinch and Patterson (2000) and Hodge (1996, p.56) concluded that regional economic development and local employment issues were significant factors in local

government outsourcing decisions *per se*, while a PSRC (1996) study exposed variations in outsourcing practices consistent with a differentiation between rural and metropolitan councils, where rural councils had economic policies giving preference to local businesses and workers. The veracity of these conclusions was exemplified by a 1999 NSW State government proposal to introduce compulsory competitive tendering for specific roads-related services in local councils. The proposal met with scathing criticism from non-metropolitan councils, and, when abandoned, was ‘welcomed by rural and regional councils concerned about job losses’ (WIN News 1999).

In addition to the direct relationship between the impact of outsourcing and local employment and other regional issues, there may well be further political dimensions to the reluctance of rural and regional councils to outsource. The use of ‘outsiders’ and losses of local jobs, in leading to community stakeholder dissatisfaction, might reflect badly on councillors and have a flow-through effect on councillors’ chances of re-election. Consequently, the outsourcing decisions of local councils may be a result of the politically motivated and self-interested behaviour of elected officials, as well as the broader social and economic concerns of the demesne they serve.

V Conclusions and implications

The TCE contention that organisations will apply a cost economising objective using a bounded rational, satisficing approach to decision making was not supported by the results of the research. When applied to outsourcing decision-making in the APS, the TCE framework appears to be doctrinaire. The theory fails to recognise the role of intra-organisational politics in decision-making and ignores the impact of externalities, such as those posited by O’Connell-Davidson (1993), including labour market conditions and political and legislative interventions. Thus, Australian PSOs outsourcing decisions may be as much or more about internal organisational politics and external political pressure as they are about achieving cost savings.

While TCE incorporates the notion of goal incongruence, the theory also fails to address how this variable may link to the political decision model. The results summarised in *Tables 2 and 3*, and in other parts of section 4 of this paper, provide evidence for concluding that some PSOs do not actively pursue a cost savings objective. While organisations, especially the larger ones, outsourced to comply with government requirements, they appeared to do so as a precipitant reaction to what they perceived as the pressures of policy, rather than for achieving

the (cost reduction) objective of that policy. By outsourcing for reasons as well as, or other than, achieving cost economical outcomes, managers are engaging in dysfunctional behaviours. There is, therefore, a *prima facie* level of goal incongruence such that the actions of managers (as agents) are not consistent with the wishes of governments (as principals). In other words, rather than the TCE view that a bounded rational decision model is used and that, *inter alia*, goal incongruence functions to promote outsourcing, the existence of goal incongruence appeared instead to foster the use of political power in influencing outsourcing decisions. Such goal incongruence was evident within the organisations studied (as exemplified by the factionalised Board and management of the case PSO), as well as between PSOs and their parent organisations (ie. governments). Eisenhardt and Zbaracki (1992, p.27) criticised the bounded rationality tenet of TCE:

most scholars accept the central ideas of the political perspective ... these observations fit both the published research and most people's day-to-day experience within organizations. And these central ideas form a much more coherent theory than do those of bounded rationality.

The current research, underscores the applicability of the 'political/competitive model ... which highlights that different participants in the decision process often have different goals' (Huber 1982, p.255). TCE ignores this acknowledged, direct relationship between the political model of decision-making and goal incongruence.

The role and significance of politics has been evidenced in studies of outsourcing decision-making in various countries. Finlay and King's (1999) examination of public sector outsourcing in the UK revealed the importance of political concerns, with the researchers concluding that:

transaction cost analysis ... in itself is not enough ... this form of analysis needs to be augmented with considerations of ... special features and of the organizational and environmental factors surrounding the sourcing decision (p.109).

The findings of the current research are also consistent with those of Ferris (1986), Ferris and Graddy (1986), and Hirsch (1995), who found that while cost and efficiency concerns were the most important considerations in making outsourcing decisions in US local governments, political factors, such as the impact of special interest groups, community political sentiments, and the political power of public sector employees, were also significant. In the Australian context, Domberger, Hall and Jeffries (1995) reported that government and budget directives were highly rated reasons for why PSOs made outsourcing decisions, while Hodge (1999,

p.455) concluded that 'privatization is as much a political and social reform mechanism as it is an economic one'.

The current research confirms that public sector outsourcing decisions and politics are linked. Political factors remain a hidden cost of outsourcing decision-making, not accounted for in conventional TCE explanations. Contracting in the APS 'raises questions about political control ... and the prospect of gaps between intention and outcome' (Chalmers & Davis 2001, p.74), and the extent to which politics supervenes, interferes with, or completely subjugates the pursuit of cost savings through outsourcing remains largely unknown and is worthy of further research.

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¹ That TCE is one aspect of agency theory is discussed in Baiman (1990).

² Results reported in this paper include discussion of responses according to organisation type, where LG = local government organisation, BF = budget-funded organisation and SF = self-funded organisation.

³ This response rate reflects adjustments made to the initial sample size of 675, which was reduced to 631 because of organisations which proved to be non-contactable or which had ceased operations.

⁴ CCT is an acronym for Compulsory Competitive Tendering.

⁵ ACCC refers to the Australian Competition and Consumer Commission.

⁶ The overall sample of organisations was divided in two, based on organisation size, producing approximately equal numbers in each category: one group comprising ‘small’ organisations (annual budget below the \$21.9 million median of the sample), and the other ‘large’ organisations (annual budget above the median).