

# Privatization/Outsourcing

**National Association of County Collectors,  
Treasurers and Finance Officers**

**2009 Legislative Conference  
March 7, 2009**





## Agenda

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### Overview

Background

Objectives

### Privatization/Outsourcing – Level Set

Definition

Key Concepts

### Privatization/Outsourcing – Today's Environment

Trends

Managing the Process

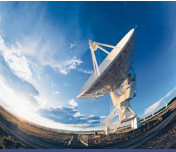
### Privatization/Outsourcing – Wrap Up



## Overview - Background

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- Shared Service Creation
- Service Level and Operating Level Agreements
- Business Process Outsourcing
- Application and Infrastructure Outsourcing



## Overview - Objectives

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- Discuss key concepts associated with Privatization/Outsourcing
- Increase awareness of trends and views of Privatization/Outsourcing
- Discuss key considerations when evaluating opportunities
  
- **What expectations do you have?**



## Agenda

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### **Overview**

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### **Privatization/Outsourcing – Level Set**

Definition

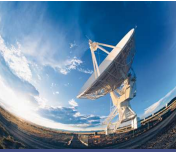
Key Concepts

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## Level Set - Definition

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There are a multitude of 'definitions' associated with Privatization/Outsourcing.

- **What do the terms Privatization/Outsourcing mean to you?**



## Level Set - Definition

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There are various definitions associated with the term Privatization and Outsourcing.

- “**Privatization** is relying more on the private institutions of society and less on government to satisfy people’s needs.”
- “**Privatization** is a dynamic concept that in the simplest sense means changing from an arrangement with a government producer to one with a private producer.”
- “**Privatization** is the transfer of assets or service delivery from the government to the private sector.”
- “**Outsourcing** is an arrangement in which one entity provides services for another entity that could also be or usually have been provided internally.”

***Relying on core competencies of others in the ‘private’ marketplace to meet a defined set of needs***



## Level Set – Key Concepts

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When discussing Privatization/Outsourcing it is important to have a sound understanding of the following:

- **What goods and services are we providing?**
- **What types of arrangements are available to provide these goods and services?**
- **What does it cost us to provide these goods and services?**
- **Is there a better ‘delivery model’ for providing these goods and services?**



## Level Set – Key Concepts (Goods and Services)

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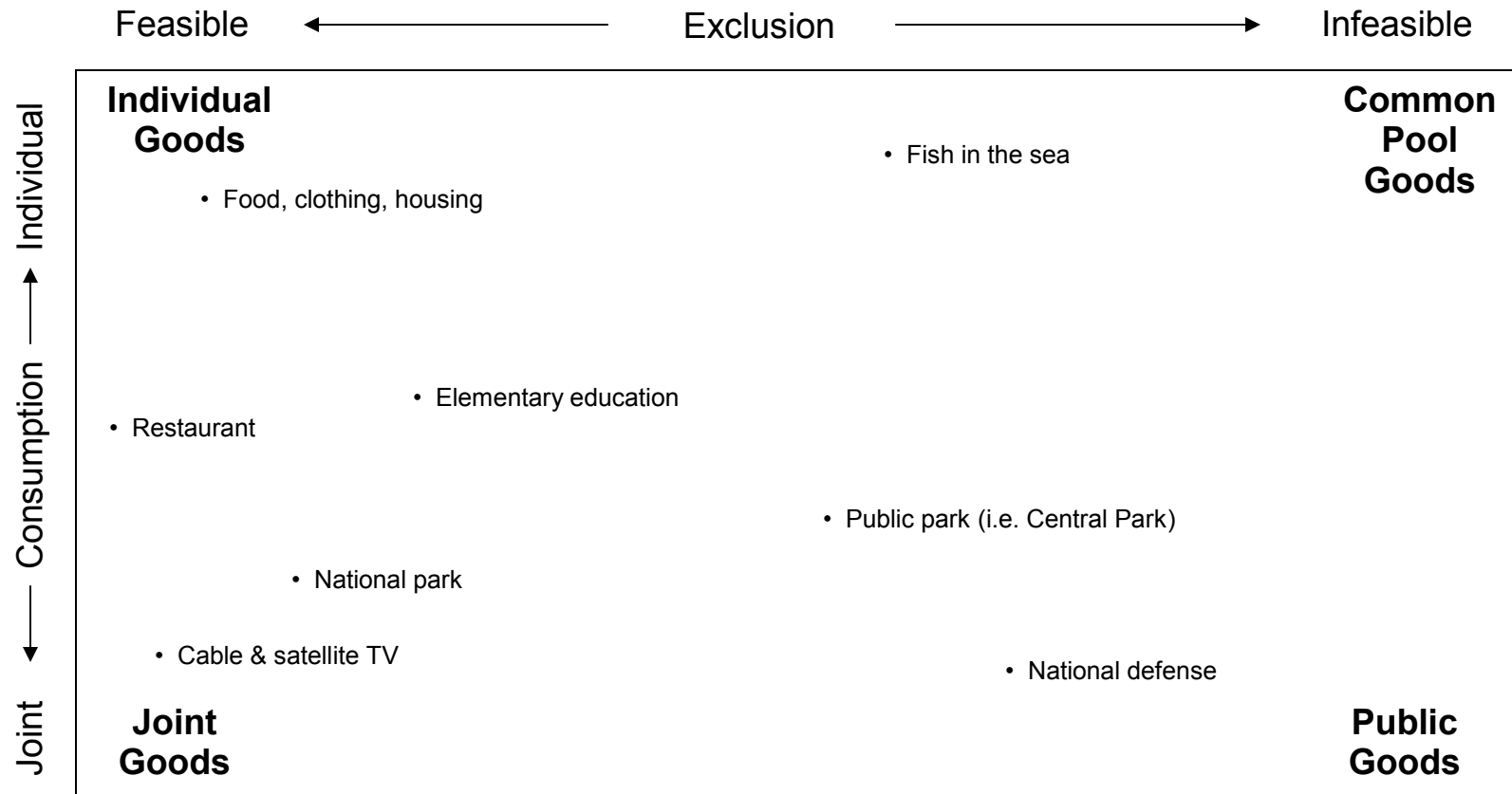
At a high level, goods and services can be classified according to two characteristics:

- **Exclusion** – is the supplier able to readily deny the use or acquisition of the good and/or service?
- **Consumption** – can the good be consumed individually or is it typically consumed more jointly and simultaneously by many users?



## Level Set – Key Concepts (Goods and Services)

Using the two characteristics of excludability and consumption, it is possible to evaluate the properties of a wide variety of goods and services.



Source: E.S. Savas, *Privatization and Public – Private Partnerships* (Seven Bridges Press pg 46 – 47)

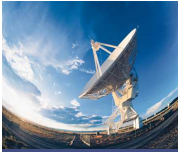


## Level Set – Key Concepts (Good and Services)

In their purest forms, it is helpful to consider the goods/services associated with the intersection of the dimensions of exclusion and consumption.

- **Individual Goods** – consumers demand goods, this demand is in turn recognized by producers and met through a mutually agreed upon arrangement
- **Toll Goods** – behave similarly to individual goods, except for the nature of the good/service being provided; goods/services tend to be natural monopolies
- **Common-Pool Goods** – goods require collective action when managing the supply of these
- **Public Goods** – goods are not easily excludable and are consumed collectively

	Easy to Exclude	Difficult to Exclude
Individual Consumption	<ul style="list-style-type: none"><li>• Individual Goods (e.g. food, clothing, shelter)</li></ul>	<ul style="list-style-type: none"><li>• Common Pool Goods (e.g., fish in the sea)</li></ul>
Joint Consumption	<ul style="list-style-type: none"><li>• Toll Goods (e.g., cable TV, electric power, telephone)</li></ul>	<ul style="list-style-type: none"><li>• Public Goods (e.g. national defense)</li></ul>



## Level Set – Key Concepts (Delivery Arrangements)

At the most basic level, there are three (3) participants in the delivery of a service: Consumer, Producer, and Provider.

Producer	Provider	
	Public	Private
Public	<ul style="list-style-type: none"><li>• Government Service</li><li>• Intergovernmental Agreements</li></ul>	<ul style="list-style-type: none"><li>• Government Vending</li></ul>
Private	<ul style="list-style-type: none"><li>• Contracts</li><li>• Franchises</li><li>• Grants</li></ul>	<ul style="list-style-type: none"><li>• Free Market</li><li>• Voluntary Service</li><li>• Self-Service</li><li>• Vouchers</li></ul>

- There are a number of service delivery models that are available in the production and provision of a service
- It is possible to be both the Producer and Provider, as well as either the Producer or Provider



## Level Set – Key Concepts (Delivery Arrangements)

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It is possible to separate production from provision, and is important to consider the attributes associated with managing the provision of services versus the production of these services.

<b>Provision</b>	<b>Production</b>
<ul style="list-style-type: none"><li>• <b>Power</b></li><li>• <b>Policy</b></li></ul>	<ul style="list-style-type: none"><li>• <b>Implementation</b></li><li>• <b>Technical Decisions</b></li></ul>

- Important to consider that it is possible that there are certain functions that do not easily lend themselves to being separated



## Level Set – Key Concepts (Costs of Services)

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It is important to consider all of the 'costs' (full costs) associated with providing services, particularly as it relates to privatization/outsourcing.

- **Capital Expenditures**
- **Fringe benefits and pension contributions**
- **Facilities costs**
- **Opportunity costs**
- **Overhead costs**
- **Avoidable versus Un-avoidable costs**



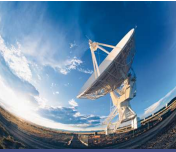
## Level Set – Key Concepts (Delivery Options)

It is important to consider the alternatives for delivering services and carefully evaluate the strengths and weaknesses of each.

<b>Public</b>	<b>Private</b>
<ul style="list-style-type: none"><li>• <b>Accountability</b></li><li>• <b>Process</b></li><li>• <b>Equality</b></li></ul>	<ul style="list-style-type: none"><li>• <b>Flexibility</b></li><li>• <b>Product</b></li><li>• <b>Efficiency</b></li></ul>

Assumption: Production can be completely separated from Provision or Policy Decision

- Government must decide how much of a good to provide and who shall receive it
- Private Sector decides how that good will be produced and delivered

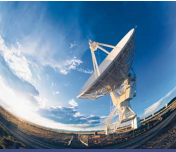


## Level Set – Key Concepts (Delivery Options)

There are some key characteristics that can provide some insight into whether or not a certain service is amenable to privatization.

<b>Contract Out</b>	<b>Retain</b>
<ul style="list-style-type: none"><li>• <b>Easily measured service</b></li><li>• <b>Variable over time</b></li><li>• <b>Routine service</b></li><li>• <b>Access to expertise (core competencies)</b></li><li>• <b>Access to technology</b></li><li>• <b>Economies of Scale</b></li></ul>	<ul style="list-style-type: none"><li>• <b>High monitoring and/or transaction costs</b></li><li>• <b>Steady need</b></li><li>• <b>Politically sensitive</b></li><li>• <b>In-house capabilities</b></li><li>• <b>Policy making</b></li></ul>

- **Are there other characteristics that might influence this decision?**



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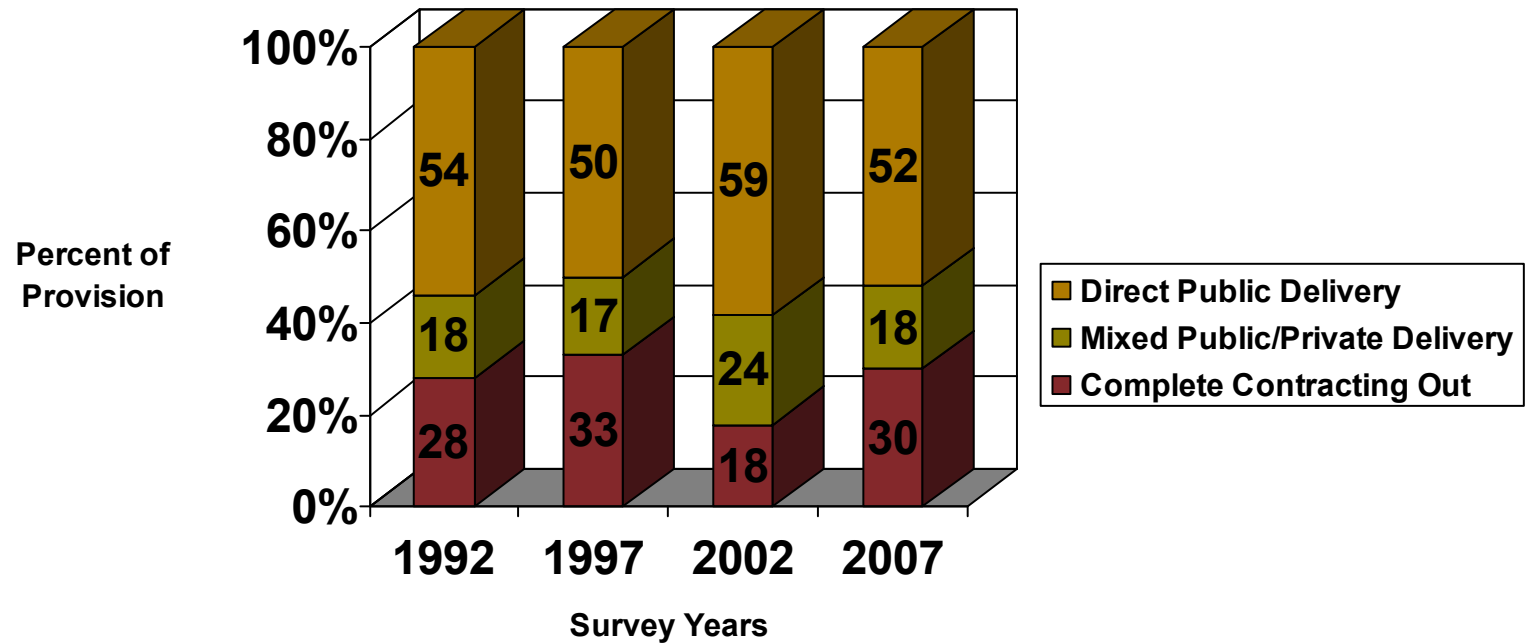
Managing the Process

### **Privatization/Outsourcing – Wrap Up**



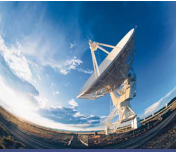
## Trends

Contracting peaked in 1997, now the Mixed and Public Delivery are Rising



Provision Rates: 66%, 61%, 53%, 49% for 1992, 1997, 2002, 2007 Respectively

Source: International City/County Management Association, Profile for Alternative Service Delivery Approaches, US Municipalities, 1992, 1997, 2002, 2007 Washington DC



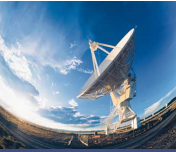
## Trends

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In the private sector there are a number of key drivers of outsourcing activities.

- **Supplement/replace non core competencies**
- **Increase flexibility/scalability of services**
- **Lower costs**
- **Provide broader technology capability**
- **Improve service performance**
- **Free up working capital**

Business Process, Application and Infrastructure Outsourcing are options that continue to be readily explored/evaluated in the private sector.



## Trends

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Business processes and the supporting technologies can be categorized in three ways:

- Core processes – activities that fulfill the mission of a company, such as exploration and production for an oil company
- Critical, non core processes – activities that are required to support the business, such as information technology, finance and accounting and logistics
- Processes that are neither core nor critical – activities or functions such as cafeteria services and facility management

Historically focus has been on outsourcing the non core and non critical processes, however, more focus is now being placed on the critical, non core processes

- **What services/processes do you think are good candidates for privatizing/outsourcing?**



## Managing the Process

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There are a number of steps that should be taken when contracting services.

- Conduct a feasibility study (business case)
- Generate a Request for Information (RFI)
- Review RFIs
- Generate a Request for Proposal (RFP)
- Review RFPs
- Evaluate Bids and award contract
- Monitor, evaluate, and enforce contract performance



## Managing the Process

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Defining the terms and conditions of the arrangement through the contracting and service level agreements is a critical success factor.

### ***Create a properly structured contract that anticipates change***

#### **Objectives:**

- Measures the quality of the services provided by the Service Provider
- Encourages the Service Provider to make appropriate business decisions
- Training, staffing, methodology implementation, and capital investments

#### **Key Elements:**

- Contractual commitment from the Service Provider
- Reflects business needs
- Allows evolution, adaptation, and changes
- Defines initial critical and key service levels, as well as critical deliverables associated with contract
- Defines all initial performance standards / targets
- Includes requirements of continuous improvement
- Defines the service-level management process
- Includes performance penalties and earnbacks



## Managing the Process

Appropriate Service Level Agreements are a key component to a successful outsourcing arrangement.

<b>Service Elements</b>	<b>Management Elements</b>
<ul style="list-style-type: none"><li>• Services provided (and perhaps certain services not provided)</li><li>• Conditions of service availability</li><li>• Service standards, such as the timeframes within which services will be provided</li><li>• Responsibilities of both parties</li><li>• Fees, expenses and billing mechanism</li><li>• Performance incentives</li><li>• Escalation procedures</li></ul>	<ul style="list-style-type: none"><li>• How service performance/ effectiveness will be tracked</li><li>• How information about service effectiveness will be reported and addressed</li><li>• How service-related disagreements will be resolved</li><li>• How the parties will review and revise the agreement</li><li>• Security standards</li></ul>



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## Privatization/Outsourcing – Wrap Up

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Bottom line, there is not necessarily a wrong or right decision as it relates to privatization/outsourcing. Consideration should be given to the specific service/function in question and the respective environment.

- There are opportunities to gain efficiencies and reduce costs through outsourcing
- Not all services/functions are amenable to privatization
- There are external factors that should be considered when evaluating the opportunity to outsource/privatize services/functions



## Resources

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There are numerous resources available related to the topic of Privatization and Outsourcing. The following present both pro and anti privatization points of view

- E.S. Savas, *Privatization: The Key to Better Government* (Chatham, N.J.: Chatham House, 1987)
- E.S. Savas, *Privatization and Public-Private partnerships* (New York: Chatham House, 2000)
- Anatole Anton, Milton Fisk, and Nancy Holmstrom, eds., *Not for Sale: In Defense of Public Goods* (Boulder, CO: Westview Press, 2000)
- Paul Starr, *The Limits of Privatization* (Washington, D.C.: Economic Policy Institute, 1987).
- Jamie Allen, [jdallen@bisgllc.com](mailto:jdallen@bisgllc.com)