

**PERFORMANCE MONITORING
AND QUALITY OUTCOMES IN
CONTRACTED SERVICES: AN
EXPLORATORY STUDY**

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Abstract

The increased use of contracting for service delivery involves new challenges in ensuring that quality is maintained. Performance monitoring involves both efficiency (costs) and effectiveness (quality) measures, however, there is little guidance from the literature to indicate the best approaches in different contexts. This paper reports on an exploratory study in which approaches to performance monitoring, and respondents' views on best practice, were explored in contracted services. Key findings are that organisations rely on inspections by their own employees or contractor checklists, but that these practices are in conflict with their views on best practice. However, the respondents were agreed that performance monitoring does have a large effect on quality outcomes.

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INTRODUCTION

Contracting out of services has become widely adopted in both the private and public sectors, and in both cases, the purchaser and service provider are separated, managerially, financially, possibly ideologically and sometimes geographically. This separation involves new challenges in managing the service delivery, ensuring that costs are contained, quality is maintained, and accountabilities established. An obvious and fundamental issue is to determine the best approach to performance monitoring to achieve these ends. This paper commences with a brief discussion of the growth in contracting, a review of the importance of and approaches to performance monitoring, and various issues related to monitoring and measuring quality. This is followed by the description of an exploratory study in which performance monitoring practices are determined and contract managers' views sought on best practice.

In the paper, contracting is used as a generic term that includes both the process of outsourcing and the execution of the contractual relations between purchasers and suppliers (Domberger, 1998, p. 12). However, the scope of the paper is restricted to issues and practices associated with quality and performance monitoring, and so it does not include the outsourcing decision process nor the search for and appointment of contractors. It does, however, incorporate challenges associated with customers, a perspective not always encapsulated by the above definition.

CONTRACTING OF SERVICES AND PERFORMANCE MONITORING

The use of contracting for service delivery is not new, but is extensive and rising (Domberger, 1998; Hunter and Gates, 1998; Rimmer, 1998). In private sector organisations this trend can be attributed to managers seeking to defend or achieve competitive positions by focussing on core competencies, and purchasing cost-effective, specialist services to cover non-core areas of their operations. In the public sector, managers and policy makers are embracing the role that competition can play to increase efficiency and effectiveness, and contracting has been widely adopted as a vehicle to achieve reform in the new public management (Hilmer, 1993; Williams, 1994). Consequently, there has been a dramatic increase in outsourcing in the public sector, both in Australia and overseas (Domberger, 1998; Domberger and Rimmer, 1994). The OECD (1997) alleges that the use of contracting in government services is increasing as the evidence is fairly clear that contracting out can lead to efficiency gains, while maintaining or increasing service quality levels. The two areas, efficiency (often referred to as productivity), and effectiveness (usually indicated by quality), are the terms most commonly referred to when the benefits of contracting are discussed. However, there is an imbalance in the number of studies that explore the two major outcomes (Hodge, 1996), and while the conclusions relating to efficiency result in apparent consensus, effectiveness outcomes are open to debate (Domberger, 1998; Hodge, 1998). The important problem that emerges from these assumptions is to determine which management processes and systems will ensure that the potential benefits are, in fact, achieved; that is, how should performance be monitored?

The importance of performance monitoring

In the context of contracting, performance monitoring appears to encapsulate three key areas: ensuring the contractor's work is faithful to the contract terms, identifying the extent of variation in quality and its relationship to cost factors, and determining whether clients and the contracting agency are satisfied with the service (Domberger, 1994; Hall and Rimmer, 1994; Industry Commission Report, 1996). Contracting organisations are also concerned with performance monitoring because they need to determine the most cost-effective approach to ensure that efficiency and innovation gains from outsourcing are not eroded

(Domberger and Hall, 1991; Hodge, 1998; Rimmer, 1998). Rimmer notes that if there is a high risk or cost associated with contract failure, it is more appropriate for the contracting agency to introduce more costly monitoring techniques but that there is limited evidence on costs associated with contract management.

The extent to which it is important to monitor performance is not only related to the risks associated with contract failure but also the extent to which the purchasing organisation is confident that the contractor is capable of delivering to the required quality standards. The Industry Commission (1996) suggests that there are two elements of risk associated with CTC, firstly, whether contractors have the capacity to perform to agreed standards and, secondly, whether those standards are being attained. Consequently they state that the two main approaches to minimising risk are the adoption of quality assurance (QA) strategies, and the development of a performance monitoring regime. Other authors suggest that QA requirements are linked to risk assessments, and that when high levels of risk exist, suppliers should be required to have third party certification (Industry Commission Report, 1996; Rimmer, 1998). The Industry Report also suggests that the way that QA and performance monitoring are used " ..is highly interdependent in that the more comprehensive the QA arrangements, the less will be the need for detailed performance monitoring" (1996, p. 351). This assertion can be challenged, based on whether more emphasis is placed on outcomes or processes (that is, the dominating perspective on quality), and whether the complex processes and long term outcomes associated with many services are adequately ensured by QA management systems and/or accreditation. There is apparent confusion between strategy and operations but, in both cases, performance monitoring is critical to inform decision-makers.

Approaches to performance monitoring

The Industry Commission Report (1996, p. 361) suggests four approaches to performance monitoring of outsourced services: performance indicators, to specify and measure performance; inspections; contractor reports, prepared by the contractor; and client complaints and surveys. The latter three approaches are techniques that can be used to monitor performance. In contrast, 'performance indicators' is a term that requires definition and exploration. Hall and Rimmer (1994, p. 456) define performance indicators as 'quantitative and qualitative statistical information which is used to assist in determining how successful an organisation is in achieving its objectives'. They suggest that three main aspects of performance can be measured by performance indicators: workload, efficiency and effectiveness measures. Workload indicators are output orientated and measure the amount of work done, for example, the number of patients treated. Efficiency indicators are economic and productivity measures, generally measuring output/input ratios, and equipment and personnel utilisation rates. Thus, workload and efficiency measures are quantitative checks, relatively simple to define, and requiring data that is generally easy to collect. Additionally, once a contract is agreed, workload and efficiency indicators are generally only relevant for the contractor (except where there is in-house delivery) (Hall and Rimmer, 1994). Outcome indicators reflect a more strategic approach rather than the operations focus of outputs.

Effectiveness indicators are designed to measure the outcome or impact of a service, that is, the extent to which the objectives of the organisation have been achieved, and they include the quality of services, the levels of customer satisfaction, and overall outcomes such as profitability or accountability for equity. Effectiveness indicators are more complex, more difficult to define, and generally require information that is not readily available. These points are particularly salient in services due to the intangible nature of services, their long term outcomes, and greater emphasis on the employee-customer interface (Domberger and Hall, 1991; Parasuraman, Zeithaml and Berry, 1985; Rimmer, 1998). Despite the difficulties of measurement in services, organisations are concerned with monitoring effectiveness as it indicates the extent to which overall service quality objectives are being achieved (Hall and Rimmer, 1994).

Previous studies on contracting and performance monitoring

In the two studies that specifically report on performance monitoring and contracting, little use appears to be made of effectiveness and overall performance indicators, or of independent assessment. Organisations appear to rely on output or efficiency indicators such as compliance checklists and user complaints. In

particular, in Australia, Domberger Hensher and Wedde (1993) found that public sector organisations rely predominantly on certification (verification by the contractor that a service is completed) whereas private sector organisations favour inspections but, in the organisations that they sampled, little use was made of third parties. In a study of U.K. local authorities, Walsh (1991) explored changes in approaches to performance monitoring before and after compulsory competitive tendering (CTC), and he found that inspections tend to be adopted after the introduction of competition. He also notes an increase in the use of user panels, public surveys and consultative committees after CTC. However, the most common methods of monitoring contracts for local government: user complaints, and public complaints, did not show significant changes. Both the studies note the significance of the relationship with the client, but for different reasons. Walsh states that 'The purpose of monitoring was not seen simply as to control the contractor, but more generally to establish cooperative relationships' (1991, p. 50). In contrast, Domberger et al. (1993) suggest that perceptions of quality are clouded by the relationships and they call for more research to explore performance evaluation of contracts.

ISSUES IN MEASURING AND MONITORING QUALITY

In relation to studies that consider contracting and quality, three themes emerge: the variations and problems in measurement of quality, the lack of information about the reasons for perceived changes in quality, and the dearth of studies on quality when compared to economic efficiency (Domberger, 1998; Domberger and Rimmer, 1994; Hall and Rimmer, 1994; Hodge, 1998; Industry Commission, 1996; Rimmer, 1998). In their review of 10 studies, Domberger and Rimmer (1994, p. 449) noted that many of the studies used incomplete and narrow measures of service quality, and that the review provided no consensus on contracting and quality.

The studies also illustrate marked inconsistencies in approaches to measuring quality. Rimmer (1994, p. 83) notes that

"There are no generally accepted measures of quality. Frequently used measures include surveys of users, changes in inputs, the range or number of outputs and performance indicators, such as a systematic assessment of user complaints."

Similarly, the Industry Commission Report (1996, p. 544) states

"Information has been obtained from one or more of three sources .. the direct response of service consumers (the number of customer complaints as a proxy for service quality), independent observation and assessment (performance indicators), and information from contract managers."

Difficulties and deficiencies in quality measurement are, at least in part, related to the difficulties in defining quality and the diverse application of the term. Hall and Rimmer (1994, p. 456) state that the term quality means a high level of quality in an economic sense (that is, as having valued characteristics) but the term quality to describe fitness of purpose is the one which is most relevant to the development of performance indicators for contracts. The trend to an increasing emphasis on the customer is clear from the economics and operations views of quality while the services marketing view is entirely dependent on the consumers' perceptions of quality as a point of comparison to their expectations. A comprehensive review and comparison of the literature on TQM and service quality is provided by Silvestro (1998) and will not be repeated here. What is evident from the literature is that the services view has not yet been embraced nor integrated in the context of contracting.

In both TQM and service quality literatures the customer is emphasised and many organisations appear to be gathering feedback via customer satisfaction surveys. However, a significant number of issues and problems in relation to customer satisfaction surveys have been clearly elucidated in Services Marketing literature over the past decade. Such issues include the use of broad indicators (satisfied/dissatisfied) rather

than specific aspects of satisfaction, the fact that such surveys often do not seek information on expectations, and the results are almost always skewed positively (Danaher and Hadrell, 1996; Stauss and Neuhaus, 1997). In addition, a wide variety of indicators, and pseudo indicators, are assumed to mean satisfaction and/or quality. Quality and satisfaction can be separated to some extent, even though they are related. Further, consumers can make objective, quantitative quality assessments and do not have to be restricted to measures of how they feel or whether, and how often, they complain.

In summary, a number of authors note the importance of performance monitoring but the different approaches to monitoring, and their possible effects on costs and quality outcomes, do not appear to be explored in the literature. Rimmer (1994) identifies two key areas for further research, firstly how to measure performance, and secondly, how to ensure that the costs of performance measurement do not exceed the benefits likely to result from their use. The practical implication that emerges from these areas is to explore the different approaches to performance monitoring to determine which approaches, in various contexts, are most likely to ensure contract compliance and appropriate quality standards. Unfortunately, despite the appeal for activity, there is little evidence of further reported research in specific management practices used for performance monitoring of contracts.

THE STUDY

Aims

Given the lack of guidance from the literature, this study aimed to explore three key questions:

1. How do organisations monitor the performance of contractors?
2. What do organisations believe to be the best approach to monitoring the performance of contractors?
3. To what extent do organisations believe that performance monitoring affects quality outcomes?

Methodology

A survey questionnaire was distributed to 'those responsible for contracting' in organisations in the Gippsland region. The questionnaire was developed based on the theory of contracting with particular reference to performance monitoring, quality maintenance and costs. The questionnaire had a combination of bipolar questions, utilising Likert scales, and open-ended questions. A large part of the questionnaire was repeated so that organisations had the opportunity to report on three different types of contracts.

A total of 355 questionnaires were distributed to a wide variety of organisations in regional Victoria, Australia. After telephone follow-up, 55 organisations (15.5%) responded, providing details of 95 different contracting arrangements. The organisations were predominantly Australian owned (76.4%) and the majority (65%) employed less than 100 personnel. Consistent with the business structure in the region, there was a proportion of large organisations that employed over 500 personnel (16%). Respondents to the survey were predominantly middle managers (55%) but senior managers (18%) were also represented, suggesting that responsibility for contracting rests at a high level. Some contract managers (11%) responded and these are likely to be from the large organisations where specific contracting roles exist.

All respondents reported on contracted services, with the main areas being building and grounds maintenance (29%), cleaning (18%), security (17%), plant maintenance (16%), and consulting and training (10%). It is interesting that all the contracted services that were reported on in this study were supplied back to the purchaser, with no responding organisation commenting on services that are provided on their behalf to a third party consumer. As many of such services, for example, community health services, recreation, and customer service functions, are more intangible and often relationship based, they are likely to present more challenges to those accountable for the performance of the intermediary. Extension of the current study to include services delivered on behalf of the purchaser is therefore an area for future research.

RESULTS

The major approaches to performance monitoring

The respondents to the survey indicated that performance monitoring does occur regularly (in 91% of cases). The major approaches to performance monitoring that these organisations use are shown in Table 1.

Table 1: Major approaches to performance monitoring

Approach used	Percentage of organisations nominating approach (N=95)*
Inspections by purchasing organisation	68
Contractor certification (of completion) or checklists	49
Customer feedback/surveys	29
Inspections by third party	11
On-site surveillance/regular contact	8
Random monitoring/spot checks	2

* Figures do not add to 100% because respondents could nominate more than one approach

As shown in Table 1, the respondent organisations reported that they rely predominantly on their own personnel to perform inspections or, alternatively, some form of checklist or certification from the contractor. In a small number of cases, organisations used both. Of interest is the lack of use of inspections by a third party or other means of independent assessment. These findings are consistent with the results of Domberger et al. (1993), as discussed previously.

The best approach to performance monitoring

The second aim of the study sought to determine what organisations believe is the best approach to performance monitoring. This was requested as an open-ended question and the results have been summarised as shown in Table 2.

Table 2: Best approach to performance monitoring

Approach	Percentage of organisations nominating approach (N=95)*
Inspections by purchasing organisation	27
Contractor certification (of completion) or checklists	15
Customer feedback/surveys	8
Inspections by third party	2
On-site surveillance/regular contact	21
Effectiveness of the service	19
Two-way feedback/consultation	13
Random monitoring/spot checks	4
Other	5

* Total does not add to 100% because respondents could nominate more than one technique

Table 2 indicates that respondents' views on the best approach to performance monitoring are inconsistent with their current practice. Inspections and on-site surveillance decrease from 76% to 48% and contractor

certification and checklists decrease from 49% to 15%. Inspections by a third party fall even lower, and customer feedback also falls. In the latter case, however, the need for customer feedback may be considered less important as the services in this study are returned to the purchasing organisation.

Of special interest are the categories relating to the effectiveness of the service and two-way feedback/consultation. While 19% of organisations felt that some outcome effectiveness measures were appropriate for performance monitoring, the respondents noted that this is often due to the specialist skills of the contractor, for instance, in finance or consultancy, and the inability of organisations to monitor the quality of work in progress. Finally, organisations appear to be indicating that they wish to work with contractors to develop relationships. In particular, they use terms such as good communication, consultative meetings, openness, common goals, clear expectations, and improved relationships. This may be indicative of the trends to collaboration and long term cooperative supplier relationships that have strengthened over the past decade (Burnes and New, 1997; Duff, 1994; Laseter, 1998).

Tables 1 and 2 illustrate some discrepancies between how contractors currently monitor performance and what they believe is best practice. On the survey, they were asked why they had nominated the 'best' approaches. Unfortunately, most did not respond to this question. However, those that did focussed on two areas: costs, and the importance of 'useful' contracts. In terms of costs, respondents suggested that some functions that they have contracted out are relatively unimportant to the success of their businesses and do not warrant greater expenditure on monitoring. In addition, 'useful' contracts were seen to establish the basis for control, and clearly outline performance, reporting and administrative obligations for both parties. These contracts were noted to have considerable impact, even when outsourced functions do not have high priority or visibility in the organisation, and were therefore seen as the first step in maintaining service quality standards.

The extent to which performance monitoring affects quality outcomes

When respondents were asked to indicate the extent to which performance monitoring ensures quality, on a scale from 1 (no effect) to 7 (very large effect), the average score was 5.59 (standard deviation 0.94). This suggests that organisations do believe that monitoring is important. However, they expressed concern about issues of value, that is, that quality measurement activities do not exceed the benefits of contracting. Table 3 shows the average scores on some selected statements regarding quality and cost, and provides some insights into organisations' attitudes. In particular, the respondents suggest that both the rigour and frequency of performance monitoring, and quality are important activities, and that contractors are able to deliver relatively low prices and high quality simultaneously.

Table 3: Responses to statements re performance monitoring, quality and cost

Statement	Mean*	SD
1. We should perform more rigorous performance monitoring	4.79	1.38
2. The frequency of performance monitoring affects the quality outcomes of outsourced activities	4.79	1.32
3. We are seeking value, that is, a balance between price and quality	6.15	0.97
4. It is price, not quality, that is important	3.02	1.68
5. Cost reduction is at the expense of quality	3.62	1.67
6. Low prices quoted by contractors reflect the quality of service delivered	3.81	1.56

* All measured on a Likert scale from 1 (strongly disagree) to 7 (strongly agree)

CONCLUSION

This study explored performance monitoring and its perceived links to quality in contracted services. Consistent with the previous study reported in Australia (Domberger et al 1993), current practice is to rely predominantly on inspections by organisational personnel or contractor checklists. However, there is a misalignment between how organisations measure performance and what they suggest are the best approaches. In the latter case, more cooperation and relationship building was suggested, highlighting the general management trend to greater collaboration with suppliers. Also suggested was a greater use of effectiveness indicators, although respondents noted the difficulties in measuring and monitoring such indicators. Of particular interest is the fact that independent assessment by third parties is only utilised to a small extent and further, organisations mention it less frequently when they nominate best practice. With specific relation to quality, respondents indicated a strong link between performance monitoring and quality outcomes. They suggested that both cost and quality are important, and that they seek a balance between them in their negotiations with contractors. Finally, there was compelling evidence that respondents believe that cost reduction is not at the expense of quality, and both are achievable.

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