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Peter M. Kettner
Arizona State University

Lawrence L. Martin
Florida Atlantic University

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Factors Affecting Competition in State Contracting for Human Services

PETER M. KETTNER

Arizona State University
School of Social Work

LAWRENCE L. MARTIN

Florida Atlantic University
Public Administration

The Benefits of Competition

Competition has long been recognized as a necessary ingredient of our economic system. Competition, it is argued, is needed to combat the negative effects of monopoly. Downs describes the negative effects of monopoly and the benefits of competition in these terms:

The classic antidote to monopoly is competition. By introducing alternative sources of supply, competition expands the choice available to consumers. Moreover, these alternative sources are likely to use different methods and approaches, or even to develop wholly new products, thus greater variety makes expanded choice really meaningful. Since consumers can shift their trade from suppliers who do not please them, suppliers have a strong incentive to provide what the consumers want. This attitude also means competitors regard innovations positively, as potential means of winning more business . . . In contrast, monopolists usually view innovations negatively (Downs, 1970, p. 264).

A number of authors have criticized government's historic monopoly of human services delivery in this country. These critics maintain that government monopoly has led to a human services delivery system that is inefficient, ineffective, unresponsive, and in some cases irrelevant, to the real needs of clients and communities (Drucker, 1969; Reid, 1972; Pruger and Miller, 1973; Savas, 1977, 1982). What is needed, in the view of these

authors, is for government to promote competition in human services delivery. The anticipated benefits of promoting competition in human services delivery are said to be numerous: promotion of innovative and creative approaches to service delivery (Newman and Turem, 1974), improved service quality (Fitch, 1974), and the creation of a pricing mechanism (Fisk, Kiesling, and Muller, 1978), that can lead to lower service delivery costs (Kettner and Martin, 1985).

Competition & Purchase of Service Contracting (POSC)

The two principal methods of promoting competition in human services delivery are the use of vouchers and purchase of service contracting (Bendick, 1984). Vouchers have been used for some time in such service areas as education, day care and transportation services (Hatry and Valente, 1983; Agranoff and Pattakos, 1985; Hatry and Durman, 1985). Purchase of service contracting (POSC) has also been used as a means of promoting competition in the human services (Kettner and Martin, 1985; Hatry and Durman, 1985). By making public funds available through POSC, the expectation is that private sector service providers will compete with one another to win human services contracts.

Of the two principal methods available, POSC clearly holds the greatest potential for generating competition in human services delivery. The federal Department of Health and Human Services, all fifty state human services agencies, and a sizable proportion of municipal and county human services agencies all use POSC (Mueller, 1980, Martin, 1986, Agranoff and Pattakos, 1985). POSC has been the major mode of state human services delivery since the late 1970's (Benton, Field, and Millar, 1978; Mueller, 1980; Martin, 1986; Kettner and Martin, 1987). Based on studies of state human services agencies, it is estimated that POSC expenditures under the federal Social Service Block Grant program alone exceed \$1 billion dollars annually (Mueller, 1980, Martin 1986, Kettner and Martin, 1987).

Despite its potential importance as a means of promoting competition in the human services, little is actually known about the real extent of competition in POSC. From a theoretical perspective general agreement exists that most types of human ser-

vices are at least candidates for competitive contracting (Hatry and Durman, 1985). From an empirical perspective, however, most of what is known about competition in POSC for human services is derived from a limited knowledge base that is perhaps best characterized as being of a case study or anecdotal nature (e.g., Massachusetts Taxpayers Foundation, Inc., 1980; Terrell and Kramer, 1984; Hatry and Durman, 1985; DeHoog, 1985, 1986; Kramer and Grossman, 1987). The evidence that does exist, however, suggests that competition in POSC for human services may be more myth than reality. If competition is generally absent in human services contracting, a disturbing question is raised in some minds: has the widespread use of POSC created situations where private sector monopolies have simply replaced public sector monopolies? (Florestano, 1982).

In an attempt to determine the extent of competition in POSC for human services and the factors that may promote, or impede it, the authors conducted a secondary data analysis of a recent national survey of the POSC activities of state Social Services Block Grant (SSBG) agencies (Martin, 1986).

Study Design

The original study conducted in 1986, involved a mail survey sent to the top administrators of the fifty state SSBG agencies. Forty-three state SSBG administrators responded to the survey as the result of the original and one follow-up mailing constituting a response rate of 86%. Specific questions were asked concerning: (a) the extent of competition present in the POSC activities of state SSBG agencies; (b) the criteria, or factors, used in making decisions about POSC; and (c) the types of POSC administrative mechanisms most frequently used by state SSBG agencies. The variables used to operationalize these concepts are discussed in the following sections.

Competition

Competition was defined as two or more contractors submitting bids or proposals to provide a service. This is a fairly standard test for the presence of competition in contracting and is based on government procurement theory (Office of Federal Procurement Policy, 1979; DeHoog, 1985; Kettner and Martin,

1985, 1987). In an attempt to determine the extent of competition experienced in each state, SSBG administrators were asked to indicate the percentage of time two or more bids or proposals were received in response to the issuance of invitations for bids (IFBs) and requests for proposals (RFPs). Because the effort necessary for precise calculations would have made responses impractical, state SSBG administrators were asked to make their best, and most informed, percentage estimates.

POSC Decision Factors

Beginning in the late 1960s a series of studies was conducted in an attempt to identify the criteria, or factors, used by state human services agencies in making decisions about the use of POSC. The question posed in these studies, in short, was: what factors were most important in your state's overall decisions to use POSC? (Booz-Allen and Hamilton, 1969; Wedel, 1974; Benton, Field and Millar, 1978; Pacific Consultants, 1979; American Public Welfare Association, 1981). The findings of these studies were distilled into eleven POSC decision factors: (1) cost considerations—the use of POSC to control, contain, or reduce the cost of service delivery; (2) service system considerations—the use of POSC to maintain or expand the human services system through increased involvement of the private sector; (3) funding considerations—the use of POSC to integrate federal and state funding with local government and private sector funding; (4) productivity considerations—the use of POSC to increase the amount of services delivered; (5) availability and capability of contractors—the effect that the presence or absence of multiple capable potential contractors has on the ability to use POSC; (6) service considerations—the nature of the services to be provided that might make POSC a more, or less, useful option; (7) client considerations—the use of POSC to enhance client access or increase service impact; (8) government organizational and policy considerations—the extent to which POSC is favored by agency policy or necessitated by the lack of government expertise or equipment; (9) history and tradition—the influence of established public-private sector relationships on the use of POSC; (10) legal requirements—the influence of state laws and regulations governing the use of POSC; (11) politics and com-

munity pressures—the effects of power on decisions to use POSC.

State SSBG administrators were asked to rate, using a six point scale, the relative influence of each of these eleven factors on their agencies' overall decisions to use POSC. A score of six was used to indicate that the POSC decision factor was considered "very important" in the contracting decisions of the state SSBG agency and a score of one was used to indicate that the POSC decision factor was considered "not at all important." By determining the relative priority state SSBG agencies place on these various POSC decision factors, it is possible to explore potential relationships between these factors and competition levels.

Based on the findings of the five studies cited earlier and other relevant literature dealing with POSC and contracting, it was hypothesized that four of the identified POSC decision factors would be positively associated with competition levels and seven negatively associated. The POSC decision factors hypothesized to be positively associated with competition levels are: cost considerations, productivity considerations, availability and capability of contractors, and legal requirements. Cost and productivity considerations are hypothesized to be positively associated with competition levels because increased competition in human services delivery is generally viewed as a method to drive down service delivery costs, increase productivity, or both (Office of Federal Procurement Policy, 1979; The Council on State Governments, 1983; Hatry and Durman 1985). The availability and capability of contractors (i.e., potential contractors) is generally considered to be the sine qua non of competition (Hatry and Durman, 1985; Kettner and Martin, 1987). Legal requirements generally fall within the context of state procurement laws and regulations, which tend to promote competitive contracting (The Council of State Governments, 1983).

The seven POSC decision factors hypothesized to be negatively associated with competition levels are: service system considerations, funding considerations, service considerations, client considerations, government organizational and policy considerations, history and tradition, and politics and community pressures. Service system considerations and funding considerations

are hypothesized to be negatively associated with competition levels because evidence suggests that when these factors are important in POSC decisions, maintenance of the status quo rather than any attempt to increase competition tends to be the result (Massachusetts Taxpayers Foundation, Inc.; DeHoog, 1985, 1986). Likewise, when service considerations or client considerations are considered more important in POSC decisions, competition tends to be less important (Hatry and Durman, 1984; Kettner and Martin, 1987).

Government organizational and policy considerations are hypothesized to be negatively associated with competition levels because where state human services agencies have a formal policy position on POSC, the policy tends to be collaborative, rather than competitive (e.g., State of Connecticut, 1984). When government lacks the necessary expertise to provide a service directly, it also is frequently less well equipped administratively to contract competitively for that service (Kettner and Martin, 1987).

History and tradition tend to promote collaboration rather than competition in POSC because established public-private sector relations were based on partnership arrangements rather than competitive arrangements (Kettner and Martin, 1986). Finally, where politics and community pressures are brought to bear on POSC decisions, these pressures are related to the funding of particular services or agencies, rather than to the promotion of competition (Massachusetts Taxpayers Foundation, Inc., 1980; DeHoog, 1985).

If the hypotheses formulated above about the relationships between POSC decision factors and competition hold true for state SSBG agencies, an analysis of the study data should reveal positive and negative correlations as follows:

*Prediction of Positive
Correlation with
Competition Levels*

- Cost Considerations
- Productivity Considerations
- Availability & Capability
of Contractors
- Legal Requirements

*Prediction of Negative
Correlation With
Competition Levels*

- Service System
Considerations
- Funding Considerations
- Service Considerations
- Client Considerations

- Government Organizational & Policy Considerations
- History & Tradition
- Politics & Community Pressures

POSC Administrative Mechanisms

Based on a review of the POSC and government procurement literature, eight administrative mechanisms used by government contracting agencies were also identified. These POSC administrative mechanisms include: the procurement processes of (a) invitation for bids (IFBs) and (b) the request for proposals (RFPs); the contract payment mechanisms of (c) cost reimbursement contracts and (d) unit cost, fixed-fee, and incentive contracts; the length of contract term either (e) single year contracts or (f) multi-year contracts; and the type of contractors used (g) government and non-profit contractors and (h) for-profit contractors.

State SSBG administrators were again asked to rate, using a six point scale, how characteristic each of the eight POSC administrative mechanisms was of their agency's overall approach to POSC. A score of six was to indicate that the POSC administrative mechanism was considered "very characteristic" of the state SSBG agency's contracting approach and a score of one was to indicate that the POSC administrative mechanism was "not at all characteristic."

In examining these eight POSC administrative mechanisms, one can again hypothesize that some would be positively associated with competition levels and some negatively. The use of the invitation for bids (IFBs) is generally associated with a more competitive environment because price or cost is the primary decision criterion, with the resulting contract usually being awarded to the lowest bidder (Office of Federal Procurement Policy, 1979). The use of the request for proposals (RFPs), on the other hand, is frequently associated with a less competitive environment because program design and service issues tend to take precedence over issues of cost or price (The Council of State Governments, 1983; Hatry and Durman, 1985).

Unit cost, fixed-fee, and incentive contracts are generally

held to promote competition because contractors know they will be paid a predetermined price for their services and, consequently, they are ultimately responsible for cost control and productivity. Conversely, the use of cost reimbursement contracts is generally associated with a less competitive environment because contractors know that this type of payment mechanism holds them harmless from financial risk since the government contracting agency agrees to defray all the contractor's costs of service delivery (Kettner and Martin, 1987).

The use of single year contracts is generally considered to have a positive effect on competition because contractors can change annually (Fisk, Kiesling and Muller, 1978; Hatry and Durman, 1985). Thus, single year contracts tend to promote competition more than do multi-year contracts. The use of for-profit contractors is also generally considered to promote competition because in a competitive environment, it is likely that every available type of contractor would be given an equal opportunity to compete. Excluding for-profits from being POSC contractors, as some state human services agencies apparently do (State of Connecticut, 1984), and restricting POSC contracts to only government and non-profit agencies is, therefore, considered as more characteristic of a less competitive environment.

If these generally held notions about the relationships between POSC decision factors and competition are consistent with the actual practices of state SSBG agencies, an analysis of the study data should reveal positive and negative correlations as follows:

*Prediction of Positive
Correlation with
Competition Levels*

- Invitation for Bids
- Unit Cost, Fixed-Fee & Incentive Contracts
- Single Year Contracts
- For-Profit

*Prediction of Negative
Correlation with
Competition Levels*

- Request for Proposals
- Cost Reimbursement Contracts
- Multi-Year Contracts
- Government & Non-Profit Contractors

Study Findings

Extent of Competition

As Table 1 illustrates, nationally competition is present less than 25% of the time in the POSC activities of the responding

Table 1

Mean Percentage Competition Levels Nationally and By Geographical Region

Nationally	North East Region	North Central Region	South Region	West Region	F-Test
(40) 23.9%	(7) 27.7%	(7) 11.6%	(14) 11.6%	(12) 43.3%	3.165*

() = Number of Cases

*p = .05

state SSBG agencies. This finding certainly calls into question the notion that competition in POSC is a widespread national phenomenon. There are, however, significant regional differences in the amount of competition present in the POSC activities of state SSBG agencies. Again referring to Table 1, competition occurs 43% of the time in the West region, while competition levels approximate the national average in the North East region (27.7%) and are considerably below the national average in the North Central (11.6%) and South (11.66%) regions. These four regional groupings were developed by the International City Management Association and have been used in previous studies involving POSC (Agranoff and Pattakos, 1985; Kettner and Martin, 1987).

Competition and POSC Decision Factors

As Table 2 illustrates, none of the POSC decision factors are significantly correlated, either positively or negatively, with competition levels. At this point we might well conclude that either: (a) the priorities of state SSBG agencies have no impact on competition levels—that stated priorities to reduce costs or increase productivity simply do not get translated in action, or (b) that the degree of competition may be influenced more by other factors and less by the conscious policy choices of state SSBG agencies. When the focus of the analysis of Table 2 shifts from the size of the correlations to their signs, however, seven of eleven signs are in the predicted direction. Five of the seven POSC decision factors predicted to correlate negatively with

Table 2

Predicted and Actual Correlations Between POSC Decision Factors and Competition Levels

POSC Decision Factors	Predicted Correlation	Actual Correlation
Cost Considerations	Positive	-.06
Productivity Considerations	Positive	.07
Availability & Capability of Contractors	Positive	-.19
Legal Requirements	Positive	.23
Service System Considerations	Negative	-.03
Funding Considerations	Negative	-.21
Service Considerations	Negative	-.07
Client Considerations	Negative	.17
Government Organizational & Policy Considerations	Negative	-.22
History & Tradition	Negative	-.01
Politics & Community Pressures	Negative	.08

competition levels have negative signs: service system considerations, service considerations, funding considerations, government organizational and policy considerations, and history and tradition. Two of the four POSC decision factors predicted to correlate positively with competition levels have positive signs: productivity considerations and legal requirements. These findings provide at least some support for the notion that POSC decision factors may be related to competition, but obviously more precise measurements are needed to further probe the nature of these relationships.

If POSC decision factors do not explain the variation in competition between state SSBG agencies, the next most probable source would be POSC administrative mechanisms.

Competition and POSC Administrative Mechanisms

Table 3 reveals a number of statistically significant correlations between POSC administrative mechanisms and competition levels, but few are in the direction predicted. In terms of procurement mechanisms, both the invitation for bids (.35) and

Table 3

Predicted and Actual Correlation Between POSC Administrative Mechanism and Competition Levels

POSC Administrative Mechanism	Predicted Correlation	Actual Correlation
Invitation for Bids (IFBs)	Positive	.35*
Request for Proposals (RFPs)	Negative	.27*
Unit Cost, Fixed-Fee & Incentive Contracts	Positive	.01
Cost Reimbursement Contracts	Negative	.01
Single Year Contracts	Positive	-.30*
Multi-Year Contracts	Negative	.58***
Government & Non-Profit Contractors	Negative	-.34*
For-Profit Contractors	Positive	.26*

*p = .05 **p = .01 ***p = .001

the request for proposals (.27) are positively correlated with competition levels indicating that these two POSC administrative mechanisms are characteristic of state SSBG agencies with high competition levels. The contract payment mechanisms show no correlations whatsoever, with both unit cost, fixed-fee, and incentive contracts (.01) as well as cost reimbursement contracts (.01) having zero order correlations.

Type of contractor variables do reveal signs in the predicted directions, but the correlations are moderate. Government and non-profit contractors show a moderate negative correlations (-.34) with competition levels, while for-profit contractors demonstrate a moderate positive correlation (.26).

The length of contract term variables show moderate to strong correlations, but their signs are in the opposite directions from those predicted. Single-year contracts reveal a moderate negative correlation (-.30) with competition levels, while multi-year contracts evidence a strong positive correlation (.58). These two findings are surprising in that they run counter to generally accepted notions that multi-year contracts retard competition and single year contracts promote competition (Fisk, Kiesling,

and Muller, 1974; Hatry and Durman, 1985; Kettner and Martin, 1985, 1987). A plausible explanation for this finding is that prospective contractors may be more willing to compete for POSC contracts when they know that success will mean a long term multi-year contractual relationship as opposed to a short term single year contractual relationship.

Summary & Conclusions

What, then, can be said of competition and purchase of service contracting (POSC) based on these findings? First, that competition does exist in the POSC activities of state SSBG agencies, but less than 25% of the time. Second, that competition levels vary significantly between regions of the country with the most competition taking place in the West region. Third, that the policy priorities of state SSBG agencies, as operationalized in the selected POSC decision factors used in this study, apparently have little effect on competition levels. Fourth, that the different POSC administrative mechanisms used by state SSBG agencies appear to have the greatest effect on competition levels. Of the eight POSC administrative mechanisms included in this study the most important in terms of promoting competition levels are: multi-year contracts, invitation for bids, request for proposals, and for-profit contractors.

While this study opens up for discussion the question of competition in POSC and, by extension, competition in human services delivery, a large number of important questions remain for subsequent research. Most notable among these are: (a) do state SSBG agencies see competition as desirable or undesirable? (b) are state SSBG agencies attempting to promote or reduce competition? (c) what benefits do state SSBG agencies perceive as resulting from increased or decreased competition? and (d) what has been the impact of competition on the cost and quality of service delivery so far? At this point, in the absence of answers to these questions, it is too early to speculate on the success or failure of competition in POSC or competition in human services delivery.

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