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ABSTRACT

Governments continue to increase their reliance on private and nonprofit agents to deliver goods and services to citizens. Yet there is a dearth of scholarly research on the critical decisions made by public managers throughout the contract implementation process—decisions that can have a profound impact on the quality of services delivered to citizens and on the accountability of contractors to the public interest. This research addresses the accountability dynamics in local government contracting by analyzing the decisions public managers make to determine whether they sanction contractors for unsatisfactory performance. This study reports the results of a national survey of local government managers and is supplemented with pre- and post-survey interview data. Although public managers have powerful tools available, especially in the form of sanctions, the results presented here indicate that several factors prohibit their execution—specifically the burdensome nature of the sanctioning process, willingness to use discretion, and the extent to which the organization is dependent on the poor-performing contractor. Understanding how and why managers use contract sanctions can elucidate both administrative decision making in the implementation process, and as importantly, the influence of this action on public accountability.

Contracting for goods and services that have been historically provided by the public sector pose accountability challenges through what is sometimes called “third-party governance” (Salamon 1981). Questions of accountability—for what and to whom (Posner 2002)—become far more difficult to answer as contractual relationships among public agencies, contractors, and subcontractors grow more complex and functionally ambiguous. For scholars of public management, the imperative is to better understand contract implementation and the accountability dynamics in third-party governance.

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One way to achieve contract accountability is through the use of incentives. Contract incentives take two forms: positive incentives, or rewards, for satisfactory performance; and negative incentives, or sanctions, for unsatisfactory performance. A growing number of contracts include incentive provisions (Behn and Kant 1999; Heinrich 2007) as a means of holding contractors accountable for their performance. Incentives provide the foundation to motivate contractors and network partners (Goldsmith and Eggers 2004), and accountability is maintained through the threat of sanction. When contract sanctions are not explicitly included in the contract or enforced, vendor opportunism can result, posing a considerable risk to public value and contract accountability. With notable exceptions (see Lambright 2009; Marvel and Marvel 2007, 2009; Shetterly 2000; Van Slyke 2007), little attention is paid to the use of incentives in studies of government contracting beyond contract specification. Although well-written contracts with specified performance measures are critical first steps toward accountability, they are virtually worthless without vigilant execution.

This study focuses on the actions of local government managers and examines the use of negative contract incentives—sanctions—in holding contractors accountable for their performance. Specifically, this article addresses why sanctions are used in some instances of unsatisfactory contract performance but not in others. To answer this empirical question, results are drawn from national survey data, supplemented by semistructured interviews with contract administrators.

Understanding the application of sanctions for unsatisfactory contract performance is important for a number of reasons. First, sanctions are a critical tool available to public managers to hold third parties accountable for their performance. Sanctions are not the only way to maintain accountability in contracting; however, they are one of the most powerful techniques to either correct or penalize performance shortfalls. Second, there is evidence to suggest that although sanctions are included in contracts, they are not often used. This insight emerged in preliminary interview data conducted by the author. A recent US Government Accountability Office (2009) report also raises this issue, citing federal agencies for not enforcing sanctions for poor performance (and continuing to provide award fees—a type of financial reward—despite performance problems). Sanctions are designed as a threat to the contractor to induce performance, signaling the purchasing organization’s commitment to consequences for poor performance. If sanctions are not carried out, then threats are empty and can compromise the performance of the current contract and jeopardize the government’s ability to control the vendor on future contracts.

Although informal means of resolution are a viable—and sometimes appropriate—mechanism to resolve performance issues, an alternative problem could arise when they are used at the expense of formal actions. “The service provider may learn from such discussions that its performance could be better, but could also realize that failure to accede to the preferences of the contracting government does not generate penalties” (Marvel and Marvel 2009, 197). The threat of sanction alone (as stipulated in the contract) may not provide enough incentive to change behavior, which means that public managers should demonstrate a commitment to enforcing corrective or punitive action for unsatisfactory performance.
CONTRACT INCENTIVES

The use of rewards and sanctions in contract design and implementation is grounded in incentive theory. Information asymmetries in principal-agent relationships lead to allocative distortions that incentives seek to address (Dixit 2002; Laffont and Martimort 2002). Dixit (2002) identifies three primary informational problems between principals and agents: moral hazard, adverse selection, and costly verification. Costly verification results when the principal is unable to observe the quality of the agent’s outcome in the absence of auditing. Adverse selection, or as Van Slyke (2007, 162) describes, “precontractual opportunism,” occurs when one party knows more about the good/service than the other, and this leads to low-quality outcomes. Moral hazard or “postcontractual opportunism” results when a self-interested party acts opportunistically to the determinant of shared goals (Van Slyke 2007, 162). According to incentive theory, appropriately designed incentives help to overcome the information inefficiencies in the principal-agent exchange (Alchian and Demsetz 1972; Sappington 1991).

In his examination of incentives in the public sector, Dixit (2002, 697) concludes that performance-based incentives should be selectively applied “to specific agencies or tasks, namely those whose performance can be defined, quantified, and measured with some clarity, and where political conflicts about different aspects of the performance are relatively minor.” Less powerful incentives should be used when technical expertise is acquired from the agent (Laffont and Tirole 1991). This is often the case in local contracting arrangements as capacity is shed through the outsourcing process. Miller and Whitford (2007) have explored incentive theory in public agencies from an alternative perspective, examining why incentives are not used in public agencies. They infer that it is often not in the principal’s self-interest to structure efficient incentives because it is cost prohibitive to do so. As a result, agencies engage in ex post monitoring, exacerbating inefficiencies in the principal-agent dynamic.

Incentive theory incorporates the “carrot and stick” approach to contract administration and assumes the threat of financial sanction or loss of the contract will motivate contractors to maximize contract performance. This occurs because the contractor-agent fears replacement by a competitor by the government-principal (Cohen and Eimicke 2008; Donahue 1989). Likewise, appropriate reward systems are expected to induce desired performance results and increase goal consensus between the government purchaser and the contractor.

Stewardship theory has also gained theoretical ground in contract management research, most notably in the nonprofit context. Scholars have examined differing approaches to contract management by comparing or combining features of both agency and stewardship theories (Lambright 2009; Marvel and Marvel 2009; Van Slyke 2007). Research in nonprofit contracting has yielded evidence that collaborative, relational approaches to contracting are more dominant, consistent with stewardship theory (although Lambright 2009 and Van Slyke 2007 contend that agency and steward theories are complementary, not mutually exclusive).

Decisions to execute rewards or sanctions fall into the realm of discretionary actions by the public manager, within the constraints of legal requirements (Brown, Potoski, and Van Slyke 2006). Rewards can be monetary in nature, to include award
fees/bonus payments or contract renewal or extension, or they can be nonmonetary, such as public praise or commendation of the contractor by the purchasing organization. Just as there are many types of contract rewards for satisfactory performance, managers respond in a variety of ways to unsatisfactory contract performance dependent upon both the constraints of the contract and their discretion. For instance, the manager may elect to take no action and ignore the performance problem altogether. The manager may address the issue informally with the contractor, opting for an “off the record” response by not recording the performance problem in contract documentation (e.g., a verbal warning or plan to correct performance). The manager may also take formal action to sanction the poor-performing contractor. A formal sanction could be a written warning documenting the infraction or the assessment of a financial penalty (e.g., withholding payment to a contractor for a deliverable; assessing damages to be paid by the contractor to the purchasing organization). The manager might also choose to terminate the contract, or in the most egregious cases, bar the contractor from bidding and/or being awarded future contracts with the agency.

Figure 1 illustrates the range of managerial responses to contract performance problems, showing the various types of sanctions (beginning with no sanction) available to public managers, escalating in intensity.1 These responses were informed through review of contract documentation (to include the Federal Acquisition Regulation, procurement templates, and current or past contracts) and interviews with contract

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1 In rare cases, a contractor may prefer contract termination to financial penalty for a low monetary contract (i.e., when the penalty outweighs the profit value of the contract). However, losing the contract and/or forgoing the opportunity for future work is widely regarded as the most damaging sanction (Cohen and Eimicke 2008; Kelman 1990).
This study attempts to specify the probability of sanctions established here and identifies impediments to imposing sanctions. The objective is to glean insights into the factors that influence the decisions public managers make that ultimately affect contract accountability.

**Examining Sanction Decisions**

Five areas contributed toward building a theoretical model to begin to answer whether public managers sanction contractors for unsatisfactory performance. Because there is little known about the use of contract incentives in public implementation, this study not only draws from public management and related literatures but also incorporates knowledge from federalism and regulatory studies—which have notable incentive features—to develop the testable hypotheses discussed in the following sections. The hypotheses also draw from exploratory interviews with contract managers. The insights drawn from these extensive interviews supported theory development and shaped the hypotheses discussed in the following sections.

**Political Support for Contracting**

The decision to outsource public services can be motivated by an ideological preference for market-based solutions (Ferris 1986; Hirsch 1995; Kettl 1993; Nicholson-Crotty 2004). Use of the contracting tool is also more prevalent where small government preferences dominate the electorate (Lowery 1982), indicative of a proclivity toward market approaches. In these instances, contracting decisions may be undermined by “the blindness of ideology” (Cohen and Eimicke 2008, 19), often at the expense of sound evaluation of the environment for outsourcing (Boyne 1998). Political preferences for market-based solutions can not only have an influence on the decision to outsource but also alter the implementation of contracts—sanctioning is a critical component of that process—as the literature and interview data assert.

Public managers consider the preferences of elected officials as they provide public services. Bureaucrats in federal agencies have been shown to respond to electoral influence and positions and adapt programmatic implementation correspondingly (Scholz and Wood 1998; Wood and Waterman 1994). In the contracting regime, elected officials are mindful of the indirect distributive impact of creating or maintaining economic benefits through private contracts (Fiorina 1989) and the potential for direct political support from contractors (DeHoog 1984). Elected officials “have strong incentives to

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2 Interviews reveal managers used a variety of techniques to sanction (or not sanction) contractors, including financial penalties (e.g., withhold payment or allocate penalty), canceling contracts, removing contractors from approved bid lists, and informally resolving performance issues (i6, i17, i12, i17, i22, i23).

3 A total of 39 interviews were conducted in this study. Twenty-four (24) semistructured interviews were conducted with public managers with contract management experience in federal, state, and local agencies. A grounded theory approach (Glaser and Strauss 1967; see also Sandfort 2000) was used as general findings on contract management revealed insights on the use of contract incentives. These early interviews also informed the development of the survey instrument. Fifteen additional postsurvey semistructured interviews were conducted to validate quantitative findings and shed light on anomalous results. For reporting consistency, interviewees were assigned a unique identifier (i1–i24 for presurvey interviews; i25–i39 for postsurvey interviews). Each interviewee is cited using this identifier to preserve their “voice.”
assist those contractors that have something special to offer. Bureaucrats can give contractors special consideration” through contract awards and management (DeHoog 1984, 26–7). These ideological motives can compromise public managers’ ability to hold contractors accountable (Cohen and Eimicke 2008; Van Slyke 2007).

Exploratory interviews demonstrated how political attitudes and interventions influence contract management strategies (i8, i16). According to one manager, political principals “willfully underestimate resources” needed for effective contract administration, constraining the government’s ability to manage and oversee contracts. She went on to say that policymakers think they are acting in the taxpayers interest by conserving resources (i8), but the reality is that accountability can be compromised when there are insufficient resources for contract management. Another manager noted that although political officials might insert themselves in the contract negotiation process, they are “generally doing it for the right reasons—[to] save taxpayers money” (i22).

Changes in political administration can also yield attitude shifts about contracting out and/or building in-house capacity. In one agency that utilized mixed delivery (similar services were both contracted out and provided in-house), internal studies revealed that in-house efforts cost less and produced more than the contractor counterparts but “there was no political will” to increase capacity (i22). Managers who were interviewed indicated that directives as well as informal signals from political principals result in more or less contracting by their organizations (i1, i4, i16, i22). These changes can also extend to the types of contracts that are used (e.g., use of sole-sourced contracts) and the management strategies that are employed (i14).

A preference for private provision can also influence the accountability mechanisms available to public managers from political principals. In a recent study, Marvel and Marvel (2009) found that

...monetary rewards/sanctions are a ‘tough sell’ for managers who seek approval for their use from elected officials. The elected officials commonly appear to believe that for-profit outsourcing requires that the tariff paid for the service depend on price and quantity and that quality will be provided in due course (200).

In essence, elected officials consider the private sector is simply able to do it better than their public sector counterparts, thus rendering positive incentives unnecessary.

Because evidence suggests that political commitment to market solutions can influence the managerial decisions that are made, managers may be less likely to impose sanctions—a critical management decision—when their political principals express higher commitment to the use of the contracting tool. By their very nature, penalties impose either financial or reputational harm to the contracting firm. When political commitment to outsourcing is high, there may be less incentive for the contract manager to penalize contractors with sanctions.

\[ H_1 \]
Sanctions are less likely when political commitment to contracting in the purchasing organization is high.

**Burdensome Sanctioning Process**

Managers have powerful tools available to hold contractors accountable for performance, yet the process that they must follow in order to execute the said tools may be
sufficiently onerous to deter public managers from their use. The process for executing sanctions for poor performance is specified in the contract between the government and contractor and is generally defined by the government’s procurement policies and procedures. Exercising sanctions can involve a range of administrative activities. In some cases, documenting the infraction or executing the sanction may be a relatively mundane process. In other instances, the process involves negotiating appropriate action with superiors, taxing amounts of documentation, or attaining multiple approvals (to include legal counsel) to proceed with sanctioning (i17, i23).

Government procurement is notoriously characterized as a rule-bound process, burdened with red tape and procedural constraints. These procurement laws, regulations, and organizational policies that govern procurements serve a dual purpose. They ensure equity and fairness in the bidding process and strive to mitigate waste, fraud, and abuse stemming from contractors and/or public managers. Although on the one hand, the constraints function to safeguard public value, on the other hand, they add to administrative costs. Procurement rules can be resource and time intensive, in addition to hampering decision making (Cohen and Eimicke 2008; Kelman 2009).

Several interviewees expressed frustration with the burdensome nature of the contracting process and believed that it served to impede rather than enhance their responsibilities as a contract manager (i1, i2, i3). As one manager noted, the “process is so bureaucratic” that it often works against effective contract management (i2). This echoed another manager’s contention that the process “promotes gridlock” in lieu of success (i3).

Interviewees also clearly linked the cost to execute sanctions to the decision to sanction for unsatisfactory performance. One manager noted that their agency was “reluctant to pursue damages” against a contractor who cracked a public monument in the course of performing the contract because the process to pursue sanctions was onerous. The contract terms allowed the agency to recover the costs to repair the damage, but the agency opted to avoid the sanction process and internalize the cost (i17). Another manager referred to a problematic contract for information technology implementation; performance issues arose with the contract and discussions ensued regarding withholding payment for services. The agency elected not to pursue sanctions because the process to do so “bogs down the state and the contractor” (i23).

This leads to the next hypothesis. That is, when the process for sanctioning involves more “red tape,” managers will be less likely to issue sanctions. Designed to create a fair and equitable process for sanctioning, the sanction process is also meant to provide critical accountability controls to maintain public value while contracting for goods and services. Yet, when the sanction process is perceived as burdensome, the public manager may not be willing to sanction even when contractor performance is unsatisfactory, preferring to opt for informal mechanisms or ignore the problem altogether.

H2 Sanctions are less likely when the sanction process is more burdensome.

Use of Managerial Discretion

Contracting for goods and services is one of the critical discretionary actions made by government managers (Vaughn and Otenyo 2007). Public managers have two primary responsibilities when they engage in contract management: to make sure that
process and policy are adhered to; and to bring contractors into compliance when performance problems arise. When public managers choose not to enforce contract terms, and consequently, fail to obtain desired outcomes, public value can be compromised and tensions can be created between administrators and political principals. As such, contracting has raised key questions about discretion—especially the potential for corruption and abuse in discretionary actions and the lack of accountability to citizens (Behn 2001; Cohen and Eimicke 2008). Discretion can open up the implementation process to manipulation and exploitation, particularly when resources are being allocated (Goodin 1988, as cited in Forsyth 1999), as in government contracting. Interviewed managers reported that discretion can also lead to confusion and inconsistency. Essentially, when discretion is used and the “rules of the game” are in constant flux, it can make management even more difficult, especially when operating in a severely resource-constrained environment.

Discretion also allows for greater flexibility and, as a result, increases efficiencies. New Public Management, with its emphasis on discretion and results-based management, is a direct response to the failures of rules and processes created by the political system (Morgan 1990). Turning implementation over to public servants allows decisions to be based on information and competence instead of political goals, ultimately increasing efficiency in implementation (Forsyth 1999; Morgan 1990). Managers often need to balance the rigidity of rules with the flexibility of context, and discretion allows for subjectivity in decision making based on the unique requirements of the situation (Lipsky 1980).

In their research on the regulatory environment, Bardach and Kagan (1982) effectively illustrate how challenging it is for individuals to strike this necessary balance between legalism and flexibility when in an evaluative role.

An inspector’s failure to insist on strict compliance can easily come to the attention of various stakeholders….Any of these observers might misinterpret or disagree with the original inspector’s assessment of the situation. Not only the inspector but also the agency as a whole can then be accused of ‘taking the law into their own hands,’ favoritism toward the particular enterprise, or of jeopardizing the health and safety of innocent persons (Bardach and Kagan 1982, 204).

Due, in part, to the reality that anyone dissatisfied with discretionary decisions can allege complaint, corruption, or favoritism against the public official and/or agency, legalism can have a tendency to prevail over cooperative approaches. This occurs “not because of their useful offensive function of providing more deterrence, but because of their defensive function of showing that the agency has been acting in conformance with laws and has been as systematic and as tough as existing manpower and sanctions enable it to be” (Bardach and Kagan 1982, 207–208). Essentially, citizens and policymakers want government to be punitive when performance is poor, and “to be tough with vendors requires considerable judgment and discretion on the part of government officials” (Kelman 1990, 90). The use of discretion is underscored by one manager’s response to performance issues. “We try to counsel and find out where the deficit is.” But with limited capacity, the manager sees two options, “we can work through it [with the contractor] or we can terminate for default and go through procurement again” (i17).

The public manager must calculate the contractor’s performance and determine the appropriate response, but in doing so, the manager must also consider
the organizational norms and policies that govern their decision-making ability (Whitaker, Altman-Sauer, and Henderson 2004). All else being equal, an organizational culture that is more flexible and encouraging of innovative decision making will likely contribute to the contract manager’s use of discretion in contract management. Interviews support this notion; according to one manager, the lack of flexibility for contract management can impede contract performance. This manager noted that the organization “stuck to schedule at the expense of [a] good deliverable.” The contractor failed to meet performance expectations, whereas, at the same time, the agency “wasn’t willing to be flexible” in adjusting the contract timeline, which ultimately hurt the organization (i22). This manager was willing to exercise discretion to enhance performance, but it was not available to her in her organizational environment. Whether public managers have discretion will affect whether they use discretion. As a result, organizational tolerance of discretion is used as a control in the statistical models discussed in the following sections.

In sum, public managers routinely make decisions based on their professional expertise and personal judgments (Hunter and Waterman 1996; Maynard-Moody and Musheno 2003; Maynard-Moody and Portillo 2010; Scott 1997; Sowa and Selden 2003). The literature is unclear, however, in the punitive context. For example, managers who have more autonomy in decision making may be less inclined to issue sanctions. Yet, it is also possible that more discretion is linked to issuing penalties. Because of this ambiguity, a nondirectional hypothesis is offered in this analysis.

H1 Managers’ willingness to use discretion has an effect on the use of sanctions but the direction of the effect is not clear.

**Trust in the Government-Contractor Relationship**

The literature states that trust in the management of government contracts is a critical dimension of contract accountability. Trust can reduce transaction costs between parties and serve as a substitute for monitoring (Edelenbos and Klijn 2007; Goldsmith and Eggers 2004; Smith and Smyth 1996; Van Slyke 2009; Vidal 2006; Williamson 1975). However, government contracting entails some level of tension between the contractor and the purchasing organization. The absence of this tension and overreliance on trust can foster a situation in which the public manager reduces or neglects oversight duties, allowing the contractor to take advantage of the purchasing organization. Thus, the degree of trust in the government-contractor relationship is an essential element of the theoretical model designed to determine the conditions under which public managers apply contract sanctions.

In the contracting relationship, trust involves a certain level of risk from both the government and the contractor in achieving expected performance and maintaining programmatic outcomes. Trust is costly—in terms of the time it takes to develop a trusting relationship, in determining which contracts receive higher levels of monitoring, and in specifying how to design incentives to facilitate and protect trust in the government-contractor relationship. Trust, reputation, and past experience with contractors are highly influential in contracting arrangements, particularly in contract selection and maintenance (Van Slyke 2007). Repeated interaction between the principal and agent (i.e., previous contracts) allows the contractor-agent to gain a
reputation for integrity, which leads the government-principal to believe they will perform to expectations (Miller and Whitford 2007).

Trust is also a key element in contract monitoring and performance management (Amirkhanyan 2009; Van Slyke 2007). There is some evidence to suggest that trust can lead to improved contract performance (Fernandez 2009; Sclar 2000; Williamson 1985). Trust also has a positive effect on future cooperation (Lambright, Mischen, and Laramee 2010), suggesting that when the government-contractor relationship is characterized as a trust-based one, there may be a decreased willingness to threaten the opportunity for future cooperation by sanctioning the contractor.

Over time, interpersonal relationships develop between contractors and the contract managers to whom they report. Under certain conditions, these relationships evolve into trust. Although trust is an important consideration in the government-contractor relationship, an overreliance on trust can arguably compromise contracting outcomes. Perceptions of “cozy insider relationships” can be problematic in cooperative relationships, particularly if performance problems are overlooked (DeHoog and Salamon 2002, 334). As trust develops, so too might complacency in expectations (Amirkhanyan 2009) or unwillingness to sanction.4

There is conflicting evidence on whether incentives foster or impede the development of trust in a relationship. According to Hardin (2002), incentives can be used to develop trust, and “[it’s] the benefits of further interaction that ride on present trustworthiness” (128). However, relying on formal market mechanisms can signal distrust and impede cooperation (Poppo and Zenger 2002), and as Marvel and Marvel (2009) find in their research on nonprofit contracting, the use of incentives “undercuts the trust central to stewardship” (190). Van Slyke (2007) shows that public managers opted for confrontation instead of enforcing sanctions when nonprofit contractors performed poorly. “Informally, public managers spoke of no longer trusting the provider, affording them less discretion and legitimacy, allocating funding incrementally rather than all at once, and scrutinizing their performance reports” (173).

Although incentives are available, some public managers rely more on leveraging trust in the government-contractor relationship to address performance problems. Managers may defer to trust as a proxy for accountability and/or not want to harm a contractor with whom they have a trusting relationship by issuing a sanction. As the next hypothesis implies, penalizing a contractor with whom a trust relationship exists will likely be an undesirable option for a contract manager, even if the contract terms require sanctions.

\[H_4\] Sanctions are less likely when the public manager’s trust in the government-contractor relationship is higher.

**Government Dependence on Contractors**

A salient concern in contracting is the level of dependence the purchasing organization has on its contractors. When public managers become overly dependent on their organization’s contractors, they risk vendor opportunism and compromised contract

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4 Poor performance might also be a result of issues beyond the contractor-agent’s control (e.g., changing user demands, incomplete contract scope, contract complexity) or competence. Quality concerns are not exclusively related to self-interest on the part of the contractor-agent or principal (Miller and Whitford 2007; Hendry 2002; Perrow 1986).
accountability. Vendor opportunism results when the contractors take advantage of their position as a preferred provider, recognizing the government is compromised in its ability to replace that contractor. This may be due to a lack of competition, inadequate technical expertise or resources by the purchasing organization to complete the contract, or both.

**Expertise**

As contracting increases, in-house government capacity diminishes because of staffing cuts and resource constraints (Auger 1999; Milward and Provan 2000; Van Slyke 2003, 2007). Inadequate capacity and expertise (Brown and Potoski 2006; Johnston and Romzek 1999; Milward and Provan 2000; Romzek and Johnston 1999, 2001; Smith and Smyth 1996; Van Slyke 2007) threaten the ability to hold contractors accountable because the remaining staff resources are simply too constrained to effectively manage their contracts. When governments fail to maintain capacity, they become dependent on contractors (Cooper 2003).

Interview data support this assertion. As one manager relayed, his agency privatized a security function nearly two decades ago, yet after multiple rounds of contracting, they learned that they needed to keep “a cadre of employees [in-house]” to mitigate their reliance on contractors (i4). Others noted that although they contract out the majority of their agency’s functions, they continue to retain some portion of technical expertise in-house (i6, i7).

The use of incentives and monitoring tools can counterbalance vendor opportunism (Barthélemy and Quélín 2006), sending signals that the government will enforce penalties and take steps to otherwise hold contractors accountable. In some cases, local governments may contract services back in (i.e., resume in-house provision) when they perceive vendor opportunism (Hefetz and Warner 2004; Lamothe, Lamothe, and Feiock 2008; Warner and Hefetz 2008). However, this is not always a viable option, especially when the contracting government has shed internal capacity, leaving it without administrative resources to internalize the service. This is especially true in capital-intensive service areas. Further, there may not be the political will to provide a once-contracted service in-house.

**Competition**

Market competition can also influence contractor dependence by the purchasing organization. Market theory and the injection of competition into government procurement is fundamental to outsourcing success (Donahue 1989; Kettl 2002; Osborne and Gaebler 1992; Savas 2000), yet many public service markets are not robust (Girth et al. forthcoming; Heinrich 2010; Hirsch 1995; Johnston and Girth 2012; Kodrzycki 1994; Sclar 2000; Warner and Bel 2008). Warner and Hefetz (2009) report survey results that nearly 31% of respondents in city governments, where competition should be strongest, report low levels of vendor supply. For local governments contracting out social services, similar problems exist (Van Slyke 2003, 2007). As a result, contractors can seize upon their preferred position, knowing the purchasing organization is vulnerable because they cannot be replaced with another firm and such contractors could have less incentive to perform at high levels. In the wake of performance failures, the government can be held hostage, unable to sanction (and therefore harm their only provider) and unable to maintain contract accountability.
Interviews revealed that a lack of competition and a dearth of bids were not uncommon for some public managers (i8; i6; i4). Public service markets are not static; a once-strong market may result in oligopoly or monopoly after several rounds of contracting (Sclar 2000). Market constriction due to vendor consolidation can be a significant concern for public managers. Not surprisingly, one manager reported that a lack of competition in the market had a direct impact on price as the number of vendors decreased from three to two (i6).

The agency’s level of dependence on the unsatisfactory performing contractor can influence the manager’s decision to sanction for performance shortfalls. There’s “much hesitation to use [contracts] to their full extent [because] people don’t want to rock the boat,” in part because there are limited firms in the market, and sanctions “can hurt competition next year [leaving the government] in a more vulnerable situation” (i17). Other managers reiterated this concern, expressing an unwillingness to terminate contractors despite performance problems because there were only two vendors in the market from which to choose (i18, i19).

In instances where capacity is constrained, institutional knowledge is lost, and competition is weak, purchasing organizations can become dependent on the contractor. When the purchasing organization is not as dependent on its contractors, public managers will be more likely to hold contractors accountable for performance—in particular, enforcing sanctions when performance is unsatisfactory. Applying the principal-agent framework, the government-principal is in a weak bargaining position and the contractor-agent has an information advantage in these dependent circumstances. Over time, the contractor knows more about the provision of the service and the true cost of the contract than the purchasing organization. In these cases, governments are challenged to hold contractors accountable for their performance when there may not be a viable alternative available to them. Managers may not be inclined to “harm” the contractor by enforcing contract penalties, despite unsatisfactory performance, as indicated in the final hypothesis.

\[ H_5 \] Sanctions are less likely when the purchasing organization is more dependent on the poor-performing contractor.

The key factors that influence the decision to sanction are illustrated in figure 2.

**DATA AND METHOD**

Data were collected from interviews and a national survey of local government contracting officials—city managers and department heads—that were collected by the author and were based on a sample drawn from The National League of Cities (NLC). The sample was drawn from NLC’s Association Management System, which contains contact information from over 40,000 local government officials across the United States. Surveys were sent via electronic mail and facsimile to a random sample of city managers and a convenience sample of functional specialists representing the directors of human services, information technology, parks and recreation, public works, and inspection services in cities with populations over 25,000 (n = 2,195). The dataset includes 332 observations for a response rate of 15%, a rate consistent with

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5 Department directors and their representatives are subject matter experts in their service area. They are also responsible for their department’s contracts and have experience with contract management.
other national surveys of local government officials on contracting issues and for data collection by NLC. Although the sample size is modest, statistical analysis reveals that it is generally representative on observable indicators.

6 Recent NLC surveys of city officials generated response rates of 17%–18%, and Hefetz and Warner’s (2012) survey of local officials on contracting had a response rate of 7%. The International City/County Management Association has conducted a national survey every 5 years since 1982 on alternative service delivery—this recurring survey has response rates of 24%–31%.

7 Two tests were performed on the representativeness of the sample. First, population, region, and service area of the respondent were regressed on survey response. Not surprisingly, cities with higher population were more likely to respond and cities in the Northeast were less likely to respond than those in the West (comparison category). This regional representation holds for other NLC surveys. Next, these characteristics were tested on whether the respondent finished the survey. The results show that city managers were more likely than other managers to complete the survey—this makes sense because city managers are often the focus of survey efforts from NLC and other organizations and thus more familiar with research. Although managers in the Northeast were overall less likely to respond to the survey as previously mentioned, they were more likely to complete the survey if they started it.
The dataset is restricted to survey respondents who have past experience with unsatisfactory contract performance because the analysis is most concerned with whether a sanction is carried out in response to performance shortfalls. This reduces the size of the sample for this analysis to 194. Problems with contract performance are treated as a prerequisite to the manager’s ability to enforce a sanction and the survey measures past experience with contract performance. Framing was used to prompt public managers to think about a single contract that best reflected their experience with unsatisfactory performance. Conceptualizing this specific contract, managers responded to a series of survey questions about the characteristics and performance of the contract.

The dependent variable, use of sanctions for unsatisfactory contract performance, measures public manager responses to unsatisfactory performance. This is a categorical variable with ordered outcomes,\(^8\) coded 0 (\(n = 71\) or 37%) if a sanction was not imposed, 1 (\(n = 66\) or 34%) if the contractor was issued a written warning or financial penalty, and 2 (\(n = 57\) or 29%) if the government terminated the contract or barred the contractor from future contracts.\(^9\)

There are five explanatory variables relating to hypotheses 1–5. Each of the variables is explained in detail below and expected directional impact on the use of sanction is provided in parentheses.

- Political support for contracting: Ordinal variable\(^{10}\) generated from response to the following: The elected/appointed officials that oversee my agency/department support contracting whenever feasible. (–)
- Burdensome sanction process: Ordinal variable generated from response to the following: The process for sanctioning a contractor involves too much red tape. (–)
- Willingness to use discretion: Past use of a manager’s discretion serves as a proxy for willingness to exercise discretion in the implementation process. Ordinal variable generated from response to the following: I usually make decisions based on standard operating procedures (inverted scale). (+/–)
- Trust: Ordinal assessment pertaining to a specific unsatisfactory contractor generated from response to the following: This contractor was among the most trusted contractors that my agency/department works with. (–)

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8 The dependent variable escalates; however, it is not treated as an ordinal variable because not all contracts are subject to all sanctions. For example, although one manager may be able to choose between issuing a financial penalty or terminating a contract, another manager may only have the ability to terminate the contract. As a result, treating the dependent variable as nominal instead of ordinal will reduce bias in the statistical model (Long 1997).

9 Treatment of the dependent variable corresponds to figure 1. Six available categories are grouped into three because of clustered responses in three areas. Ranges of response include the following: (a) the manager took no action (\(n = 7\), or 3.6%), (b) the manager resolved the issue with no formal sanction (\(n = 64\), or 32.9%), (c) contractor was issued a written warning (\(n = 15\), or 7.7%), (d) contractor was assessed a financial penalty (\(n = 51\), or 26.3%), (e) government terminated the existing contract (\(n = 50\), or 25.8%); and (f) government barred contractor from future contracts (\(n = 7\), or 3.6%).

10 Respondents selected from a Likert scale: strongly disagree (1), disagree (2), neutral (3), agree (4), and strongly agree (5). This scale is used for ordinal questions, unless otherwise noted.
Dependence on contractor: Two measures capture this construct: (1) Index expertise variable pertaining to a specific contract generated from responses to the following: My agency/department had the technical expertise to provide this service in-house; My agency/department had the resources available to provide this service in-house. (2) Ordinal competition variable rating the competitiveness of the contract generated from response to the following: This contractor could have easily been replaced with another vendor. Although the measures of competition and expertise are closely related, factor analysis and the Cronbach’s alpha score of the combined measures confirm they are two separate constructs.

In addition to the key explanatory variables, there are a number of theoretically relevant controls in the models, as described below. See Table 1 for descriptive statistics.

- Attitude toward contracting: The use of sanctions will decrease as positive attitudes toward contracting increase. Index variable generated from responses to the
following: I trust most of my agency/department’s contractors to act in good faith; I trust most of my agency/department’s contractors to adhere to contract terms.

- Commitment to incentives: Performance-based contracting is premised on the use of positive and negative incentives; therefore, it is expected that as the organization’s perceived commitment to incentives decreases, the use of sanctions will decrease. Index variable generated from responses to the following: My agency/department is committed to the use of rewards to enhance contractor performance; My agency/department is committed to enforcing sanctions to enhance contractor performance; Our elected/appointed officials are committed to enforcing sanctions to enhance contractor performance; Estimate of agency/department contracts that use incentives.

- Contractor capacity: It is expected that greater administrative capacity by the contracting firm will result in better performance and thus decrease the use of sanctions. Index variable generated from responses to the following: This contractor had the staffing capacity needed to complete my agency/department’s contracts; This contractor had the financial capacity needed to complete my agency/department’s contracts.

- Discretion—organization: It is expected that organizational tolerance for managerial discretion will affect the manager’s propensity to exercise discretion and thus affect the use of sanctions. Ordinal variable generated from response to the following: My agency/department rewards out-of-the-box decision making.

- Duration of contracting relationship: It is expected that the longer the contractor and public manager have worked together, the less likely sanctions will result. Continuous variable capturing the number of years the public manager has worked with the contractor.

- Experience: The public managers’ experience with managing contracts may also influence their willingness to impose sanctions. Continuous variable capturing the number of years the individual has managed public service contracts.

- Government capacity: It is expected that greater administrative capacity will result in more vigorous performance monitoring, and because of this, there may be more opportunity for corrective action or counsel on contractor performance and less need for sanctions. Index variable generated from responses to the following: My agency/department has sufficient staffing to administer and monitor contracts; My agency/department has sufficient expertise to administer and monitor contracts; My agency/department has sufficient time to administer and monitor contracts.

- Population: It is expected that larger governments will have more experience with contracting; a greater propensity to sanction may result in municipalities with higher population. Continuous variable reporting the log of municipal population.

- Sector: The type of unsatisfactory contractor may influence the decision of the public manager to impose sanctions. Managers may take a more relational approach to resolving performance problems with nonprofit firms and other governments and are more likely to use sanctions with for-profit firms. Binary variable identifying unsatisfactory contractor as a for-profit firm.
• Service area: The nature of the service that is being contracted may affect whether the manager issues sanctions. Series of binary variables indicating whether the contract pertains to building inspection (n = 15, or 7.8%), city administration (n = 55, or 28.4%), human services (n = 14, or 7.2%), information technology (n = 22, or 11.3%), parks and recreation (n = 43, or 22.2%), or public works (n = 45 or 23.2%). Figure 3 provides a breakdown of the use of sanctions by service area. With the exception of building inspection, managers report using all three sanction responses (no sanction; written/financial sanction; termination/bar future contracts sanction).

RESULTS

Survey Results

Stata10 is used to produce a multinomial logistical regression model. Table 2 provides estimates for “written/financial sanction” compared to “no sanction” and “termination/bar future contracts” compared to “no sanction.” The coefficients and standard errors (SEs) are generated using a clustering technique to obtain robust SEs. Predicted probabilities are calculated to discuss the results of the explanatory variables (while all

\[ \text{No sanction} \quad \square \quad \text{Written/Financial} \quad \square \quad \text{Terminate/Bar future} \]

Managers responded based on one service area, not multiple.

Using clustered standard errors relaxes the assumption that each observation is independent (Primo, Jacobsmeier, and Milyo 2007). Conceptually, this model presumes that respondents from the same state are related and it is controlled for with 40 state clusters. For example, municipalities from the same state face similar structural constraints imposed by state constitutions and legislative action. The need for this control was further supported during the interview process as respondents from some states described state-level restrictions on procurement by local governments.
other variables are held at their mean or modal binary values). Predicted probabilities are graphically displayed in figures 4–7.

The model performs reasonably well; political support for contracting, burdensome nature of the sanction process, willingness to use discretion, and dependence on contractor expertise exert significant effects on the use of contract sanctions. As expected, burdensome sanction processes are negatively associated with issuing written/financial sanctions. This statistically significant result supports hypothesis 2. As illustrated in figure 4, when managers strongly agree (5) that the process involves too much red tape, the probability of issuing written/financial sanctions is 21%, yet when managers strongly disagree (1), the probability is 51%. Although the direction is the same for written/financial sanctions, the finding does not reach statistical thresholds for termination/bar future contracts sanctions compared to no sanctions.

The government’s level of dependence on the contracting firm is measured in terms of expertise and competition. Competition effects are not statistically significant,
but dependence on contractor expertise is negatively associated with the use of contract sanctions. Managers who agree they are highly dependent on the expertise of the contractor are less likely to use termination/bar sanctions, consistent with hypothesis 3. Figure 5 illustrates that when managers strongly agree (5) that they are dependent on the poor-performing contractor’s expertise, the probability of using termination/bar sanctions is 13%. For managers who state they strongly disagree (1) that they are dependent on the poor-performing contractor’s expertise, the probability of using termination/bar sanctions increases to 38%. Comparing written/financial sanctions to no
sanctions does not yield statistically significant results; however, the direction of the effect is consistent with termination/bar sanctions.

Managers who have exercised discretion in past decision-making processes also exhibit a negative significant effect—albeit a small substantive effect—on the use of sanctions. As figure 6 shows, when managers agree (4) that they exercise discretion, the probability of issuing written/financial sanctions is 25%; however, when managers strongly disagree (1), the probability of issuing written/financial sanctions is 28%, compared to no sanctions. This finding holds after controlling for the extent to which the organization allows discretion. Recall that hypothesis 3 did not predict the direction of the impact of discretion on sanctioning behavior. The direction of the effect is the same when comparing termination/bar sanctions to no sanctions, but it does not reach statistical thresholds.

Trust is not statistically significant in this model; therefore, hypothesis 4 is unsubstantiated.

Contrary to expectations, sanctions are more likely when managers work in organizations politically supportive of contracting; thus hypothesis 1 is not confirmed. Figure 7 illustrates that the probability of issuing termination/bar sanctions is 5% when managers strongly disagree (1) that elected officials are supportive of contracting, whereas the probability of issuing termination/bar sanctions is 50% among managers who strongly agree (5) that elected officials are supportive of contracting.

In general, service area does not appear to be a strong predictor of sanction use. Information technology is negative and statistically significant, indicating that respondents in this service area are less likely to provide written/financial sanctions than their counterparts in city administration (comparison category). The result for building inspection services is negative and statistically significant, indicating that building inspection directors are less likely than city administrators to issue terminate/
Three other control variables reach levels of statistical significance and their directional effect comports with expectations. First, managers who perceive strong organizational commitment to the use of incentives are more likely to issue both written/financial sanctions and termination/bar sanctions. Second, managers are less likely to issue termination/bar sanctions when they report more positive attitudes toward contracting. Finally, managers from more populated municipalities are more likely to issue termination/bar sanctions.

**Interview Results**

This section adds contextual interview data to the discussion of survey results as they pertain to the five hypotheses. Fifteen additional semistructured postsurvey interviews were conducted with public managers from varying service areas. The interviews generally validated the findings from the survey and provided additional insights into results, especially those that were contrary to hypothesized expectations.

Although it was hypothesized that ideological commitment to contracting would overshadow performance management techniques (if those techniques—such as termination/bar sanctions—could harm the private firm), this does not appear to be the case. This is in large part due to a sense that a political and policy commitment to contracting means dealing with performance problems to maintain public value. Managers reported a connection between their decisions to hold contractors...
accountable and political support for contracting—as one noted “[it’s] easy to be more assertive in managing projects when we have the council’s support” (i26).

The interviews also showed that political actors defer to professional expertise in contract management. A public works director stated that although he works in a “strong union and strong politics state, most politicians would not trump quality [work].” He went on to say that “ultimately I will be responsible for the outcome of the project. My only recourse to get the contract done with politics [in the process] is to penalize [when there are performance issues]. Usually politicians will let that fly because they realize they’re not the professional on the job” (i27).

When public managers find the process for sanctioning to be burdensome, they are more likely to avoid sanctions. Interview results validated the finding, implying that managers clearly calculate the costs and benefits associated with the sanction process. They judge the merits of imposing sanctions against the potential losses in terms of time, financial resources, and goodwill with contractors and other actors in the contracting arena. As one public manager noted, if the amount of damages is small, then the issue is generally resolved out of court. The questions involved are as follows: “How large [is it], and is it worth fighting for” (i26)? This can lead managers to resolve performance issues through other mechanisms and not enforce the terms of the contract. “The money you recoup will never be enough to complete the contract… [and you are] never going to recoup what you pay your attorneys. So you’re better off trying to work out a deal with a contractor in taking corrective actions [rather] than punitive actions” (i27).

Legal action is not the only burdensome sanction process that managers report avoiding. One public manager opted to “take [contractors] to the woodshed” when performance issues arose in lieu of going through a formal sanctioning process (i25). An information technology manager elected not to sanction a consistently poor-performing contractor and instead decided to insource the work once the contract expired (i28). Two parks and recreation directors noted that they first seek to correct behavior and only in rare cases, choose to go through the sanction process (i34; i32). Pursuing punitive actions against the contractor—even though they are in the contract—are often used only as “a last resort” (i35). This finding illustrates the balance public managers attempt to maintain between holding contractors accountable and utilizing their resources effectively (in terms of time, staff, and even expending political goodwill).

When public managers are reluctant to exercise discretion, they are more likely to impose a written/financial sanction. Interviews also show that more discretion yields fewer sanctions and less discretion leads to more sanctions. One manager spoke of operating in “a lot of gray area. In a contract, there’s…legal lines on the left and right side and we do what’s in our power, but I give the benefit of the doubt to the contractor more than I do my own employees” (i35). Similarly, he tends to offer more flexibility, exercising his autonomy, and consequently sanctions less than he might otherwise. This result validates the notion that personal judgment influences the decision to sanction contractors for poor performance, and when public managers have less autonomy, they are more likely to pursue formal sanctions instead of informal resolution. Eighty-eight percent of managers who reported that their response to unsatisfactory performance was selected because it conformed to contract terms took formal action.
against the unsatisfactorily performing contractor. This finding further validates the assertion that when managers use more discretion and stray from adhering to contract terms, they are more likely to not use sanctions.

Trust does not appear to have a significant effect on the use of sanctions. Trust tends to get the most attention in social service contracting scholarship (Lambright, Mischen, and Laramee 2010; Van Slyke 2007), but only one of the four human services managers interviewed indicated that trust mattered in his contracting decisions. Even in this case, he said that trust is important but it is not a proxy for monitoring; “trust is a big thing, but trust has to do with whether the service delivery is carried out….We do extensive monitoring once a year….We trust but we have to have something to back up that trust” (i39).

For those who contend that trust is not important, there are indications that trust does have some impact on their contracting relationships. A public works director said “If it’s a trusted contractor, I say ‘send me the A team and not the B team on this job’…[but] regardless, you’d impose the fine just as easily” (i27). Likewise, a human services manager indicated that “we consider trust issues during our contract management but not in a formal way. The findings themselves won’t change but maybe our approach changes. We may push further if there’s a history of performance problems, but we would do that regardless of the program” (i38).

Similarly, a parks and recreation director stated that if he works with a “contractor that we trust greatly but if there’s something wrong, then we’ll be just as hard on them as we would a company new to town or have no experience with. We might feel worse about people we’re familiar with, but wouldn’t treat them any differently” (i32). Questions remain whether this familiarity really does produce neutrality in managing performance problems. There may be reason to be skeptical about the nonfinding of trust in this study; responses might be biased because of the general expectation that civil servants should be neutral in their decision making.

The government’s level of dependence on the contracting firm affects the public manager’s decision to use severer termination/bar sanctions. Interviews validated the survey findings. Managers are held hostage by firms providing essential services, especially when they have shed their internal capacity to take on the contract. This is perhaps best demonstrated by a public works director’s experience with garbage collection.

If I have a poor [performing] contractor, I’m going to try to work with him as much as possible because it’s an essential service. I can’t kick him off the site and take it over. I see that a lot in the industry. That’s something that bites us….That’s why it’s important to have continuous, relentless inspection and take immediate action (i27).

One public manager compared operations in his current position to one held in a different municipality, opining that the lack of personnel and equipment in his present setting influences his ability to hold contractors accountable. He observed that if “I had the in-house resources, [I would] pull the trigger less reluctantly than I would today” (i31). He went on to say that when he worked in an organization that did have

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16 This was an open-ended question asking why the manager chose the particular action they did to address the performance shortfall. There were 161 responses to this question (83% of sample in models).
the resources available to complete the contract, he was more likely to sanction for performance problems. Maintaining some level of in-house capacity is one way to attenuate contractor dependence. As a parks and recreation director reported, “we haven’t given up our equipment…they’re smart and know we still have it and…we can do it ourselves. [Contractors are] aware we still have our own capacity” (i32).

Survey results were inconclusive on the second measure of contractor dependence—the influence of competition in the use of sanctions. Interviews also revealed mixed results on the competitiveness of the public service markets and the ease with which vendors can be replaced. A public works director reported “[I] haven’t had to pull my punches because of lack of performance because I’ve always been able to find other vendors to do the work” (i26). Yet another public works director identified several functional areas in which he experiences minimal competition even though he is near a major metropolitan market (i33). Location effects can be profound, however, as several managers remarked their proximity to metropolitan markets made it easier to draw from larger vendor pools (i30, i31, i33, i39).

In sum, the interview results show substantial support for the survey outcomes and clarify anomalous results. The following section discusses the contribution of these findings to public management theory and practice. Limitations of the study and directions for future research are also considered.

DISCUSSION

The research shows that disparate use and severity of sanctions is dependent on managerial, institutional, and environmental factors. The use of less-severe sanctions—written documentation and financial penalties—are impeded by administrative process and managerial discretion. Alternatively, political support and dependence on contractor expertise are more likely to influence the use of severer sanctions, such as contract termination and barring the contractor from future work with the organization.

The results underscore the impact of administrative process on the willingness of public managers to fully execute the power of the contracting tool. Although administrative process has an effect on lesser sanctions, in cases of severer sanctions, such as contract termination, burdensome administrative practices are less important. From a practical perspective, this suggests it is possible that more vigilant enforcement of less-severe sanctions might correct noncompliance issues earlier on during the period of performance and mitigate the need for severer action.

The literature is unclear on the direction of the relationship between discretion and sanctions, but the survey and interview results from this study are consistent—both indicate that managers are more likely to impose sanctions when they use less discretion. This means that public managers who strictly adhere to standard policies and procedures will be more likely to enforce the terms of the contract when faced with performance failures and thus more likely to utilize accountability strategies for less-severe sanctions. This relationship holds true when controlling for whether the public manager actually has discretion (i.e., works in an organization that promotes discretionary decision making). The implication is that less discretion nudges the manager toward a “letter of the law” approach to contract management and away from a
more negotiated approach to performance conflict resolution. Essentially, discretion appears to work in the favor of the contractor; even in instances of poor performance, the general predisposition is to give the contractor a break. This finding provides a preliminary understanding of the relationship between managerial discretion in contract implementation and managing for accountability and moves toward resolving the ambiguity of hypothesis 3.

As political commitment to contracting increases, so too does the use and severity of sanctions. This is an important finding. The data indicate that the expectation to maintain public value on the part of policy makers can outweigh their overall political endorsement of contracting, setting aside ideological goals. Public managers who work in organizations with a strong political commitment to contracting find increased support for using accountability tools and enforce severer penalties on contractors who fail to meet performance thresholds. This suggests local government contracting has become less ideological and is viewed more as a legitimate implementation tool, supporting Brudney, Fernandez, Ryu, and Wright’s (2004) state-level findings. The finding also implies an association between political and managerial effects.

The political-managerial relationship proposed here is consistent with political control perspectives; that is, elected officials use (or choose not to use) oversight mechanisms to meet reelection and policy goals (Fiorina 1989; Ogul 1981; Shipan 2005). Because politicians have electoral incentives to promote quality service delivery, they defer to the expertise of the public manager to most effectively execute the contract to ensure quality services are delivered to the electorate. This includes the use of sanctions, which might be punitive to the contractor.

When the purchasing agency does not have the resources or expertise to provide the good or service being contracted, the government is significantly disadvantaged in its ability to hold contractors accountable for poor performance. Even when public managers find performance failures, they are not likely to use severe sanctions when they are highly dependent on a contractor’s expertise. This suggests that public managers weigh their organization’s vulnerability and the effects of punitive action on a firm that they heavily rely upon for service continuity prior to using sanctions on a poor-performing firm. The substantial reliance on the expertise of the underperforming contractor and unwillingness to sanction undermines the purchasing organization’s ability to maintain accountability. This supports the notion, long stressed in the contracting literature, that when governments shed capacity and resources to perform contracted services they are at risk for vendor opportunism.

One way to stave off contractor dependence is to retain at least a portion of in-house capacity for the services being contracted. Several interview respondents stressed the merits of this approach—utilizing their comparably small in-house staff for special projects or emergency work, but also allowing them the flexibility to call on this core group of in-house personnel for routine tasks in the event of contract problems. However, this practical recommendation is highly dependent on the service area. For large-scale capital contracting, it becomes less likely that managers can justify retaining equipment, facilities, and staff to maintain capacity (in fact, the desire to shed the costs associated with these production assets often drives the decision to outsource in the first place).
Trust is generally regarded as an important variable in contracting relationships (Amirkhanyan 2009; Edelenbos and Klijn 2007; Lambright, Mischen, and Laramee 2010; Van Slyke 2007, 2009), but trust appeared to have no effect on the use of sanctions. This could be a “good news” story, suggesting that public managers exercise neutrality in providing contract oversight exacting punitive measures when merited. The interview data indicated that public managers might draw on trust on the margin to resolve management issues and leverage the relationship to help hold contractors accountable. However, there is little evidence that managers in this study used trust as a proxy for monitoring contract performance or providing leeway to trusted contractors. This should be read with caution, however, because response bias may be an issue—that is, the socially acceptable response for the public manager may be to deny that trust affects the decision to hold contractors accountable. This finding suggests that additional research on the topic of trust in the government-contractor relationship is warranted, in part because this finding appears to conflict with the existing literature on trust in government contracting.

In sum, when negative incentives are not implemented as they were intended during contract design, contract accountability can be compromised. Maintaining contract accountability relies on governance mechanisms, such as incentives, to drive performance and achieve effectiveness and efficiency. It is well documented that empirical studies are mixed in finding that contracting yields efficiencies (see Bel, Fageda and Warner 2010; Bel and Warner 2008; Boyne 1998; Donahue 1989; Hirsch 1995; Hodge 2000; Savas 2000; Stein 1990). Ineffective use of contract incentives might be a contributing factor to the lack of efficiency gains from contracting. Addressing some of the impediments to sanctions raised by this study—process, discretion, and resource dependence—may contribute to improving the effectiveness of outsourced public services.

The findings from this study provide important first steps in examining the strategies public managers utilize to manage poor-performing contractors and how their decision making affects public accountability. Yet the research is not without limitations. First, the analysis relies on perceptual data. This is primarily because of the lack of objective measures of contract management data. Although there are concerns regarding self-reported data, contracting scholarship has long been advanced through the use of survey data (select recent studies include Brown and Potoski 2003; Fernandez 2009; Hefetz and Warner 2012; Lamothe, Lamothe, and Feiock 2008). Next, the scope of the study is limited to local governments and, therefore, the results cannot be generalized to other units of government. Similarly, the sample does not include municipalities with populations less than 25,000, making results less generalizable for smaller cities. Even so, the municipalities represented in the survey are areas with the greatest impact due to the higher concentration of population. The results presented here should also be tempered when generalizing across sectors. Contracts with nonprofit organizations and other governments are included in this analysis but comprise only 11% of the sample; therefore, the results are more applicable to for-profit contracting arrangements.

The likelihood of sanctioning a poor-performing contractor might differ based on severity (whether the infraction was fraudulent behavior or an untimely deliverable) and frequency (how often the contractor fails to perform). The survey did not account
for these attributes; however, 70% of respondents reported that they were “completely dissatisfied” or “dissatisfied” with the overall performance of the contractor. This does not speak directly to the severity of infraction, but it provides a sense that managers reported on performance problems that were substantive. Consequently, the findings presented here are likely a conservative estimate. For example, the results show that managers are more likely not to sanction than use termination/bar sanctions when they are highly dependent on contractor expertise. If the infraction were minor, then managers would be even less apt to sanction if they were highly dependent on the expertise of the poor-performing contractor. Controlling for severity would likely strengthen the results. A comparable argument can be made for frequency of noncompliance.

Despite its limitations, this study is among the first to provide empirical evidence of managers’ behavior when confronted with contractual performance deficiency and the decision to sanction. It has contributed to advancing theory on this topic by teasing out the factors that impede the use of contract sanctions and providing insight on the implementation of this accountability mechanism.

In addition to further exploration of the findings related to political-managerial interactions, discretion, and trust, several potential areas for future research emerge from this study. The focus of this study was limited to contract sanctions, but deeper analysis of the use of contract rewards is also merited. Comparative analysis of positive and negative incentives can allow scholars to begin to answer contingent implementation questions and add to our understanding of the effectiveness of incentives as an accountability tool. Similarly, informal resolution techniques provide public managers with an alternative to formal sanctions, and although these techniques were not explicitly explored in this study, the effectiveness of informal approaches deserve attention. Finally, exploring the connection between use of incentives and contract outcomes yields important questions; for example: Is overall contract performance enhanced when managers apply sanctions and/or rewards? Are managers more satisfied with contract performance when incentives are used? It is my hope that these and other questions raised from this study will spur further research in this area.

CONCLUSION

This study aimed to answer a vital question related to contract implementation—whether public managers sanction for poor contract performance. The results of this research show that merely specifying the terms of the contract to include performance sanctions is not enough to hold contractors accountable. Although public managers have powerful tools available to attain contract accountability, this analysis identifies factors that work against their execution—specifically the amount of discretion

The logic holds for two other confirmed hypotheses. The results show that managers are more likely to not sanction than to issue written/financial sanctions when they use more discretion and when the process is perceived as burdensome. In these instances, if the severity of the infraction was minor, then managers would be even less prone to sanction. The remaining finding of a positive relationship between sanctions and political support for contracting might suggest that ideological endorsement leads to inappropriate contracting choices and gives rise to major problems worthy of severe sanctions. Although severity is not controlled for in the study, this implication is not supported by postsurvey interview data. It is an empirical question for future study.
managers choose to use, the level of administrative burden associated with the sanction process, and the extent to which the purchasing organization is dependent on the poor-performing contractor’s expertise.

Public managers design contracts with incentives to achieve performance goals and provide one way of maintaining contract accountability. Although the inclusion of sanction terms in contracts is commonplace, the conditions under which public managers exercise them has not been well understood. This analysis shows that managers must balance the tradeoffs between accountability and process—calculating the costs associated with taking action for poor performance and the benefit that may be derived from expending the resources to do so. Sanctions are used to tighten accountability in contracting, but as this study indicates, they are not always executed, thus underscoring the complexities public managers face in holding contractors accountable in third-party governance.

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