

In contracts, we trust—managing risk in public contracts through a relational approach

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A recent *Public Money & Management* theme issue (Rana et al., 2022) examined risk management in the public sector. In an increasingly fragmented public administration landscape (Elliott et al., 2022), public sector risk is often distributed across vast contractual networks. When these public contracts fail to deliver, it is the public sector which bears the brunt—public money is wasted, citizens lose out on a service and, regardless of who was at fault, government’s reputation is tarnished (Heinrich and Choi, 2007). As a result, any attempt to better manage public sector risk must consider how to better manage public contracts.

Recently, the UK has witnessed a series of high-profile contracting failures. The government’s effort to outsource probation services under *Transforming Rehabilitation* was marked by a series of challenges that ultimately led to the cancellation of contracts (at further public expense) and the return of the service to public sector provision (NAO, 2019). In a very different sphere of public contracting, the Ministry of Defence’s new armoured vehicle programme has ‘gone badly wrong’ (Committee of Public Accounts, 2022). The Ajax programme was supposed to deliver 589 vehicles under a seven-year, £5.5 billion contract. Having already overrun by five years, it has at the time of writing delivered just 26 vehicles—none of which can actually be used—with £3.2 billion spent (ibid.).

Traditionally, contracts have tended to be framed as transactions—simple, short-lived, adversarial exchanges in which each party seeks to maximize its divergent interests (Macneil, 1974). The contract serves as an uneasy ceasefire, ensuring neither side harms the interests of the other, supported by the threat of litigation. When something goes wrong, it tends to be attributed to malfeasance or incompetence on the part of either purchaser or provider (or both).

Towards trust in contracts

However, for many contracts (including those outlined above), the transactional model does not hold. Public–private contracts are often long-term relationships to deliver complex products—such as advanced military equipment or multi-faceted public services—in which

parties' interests are relatively well aligned with one another. In these cases, the transactional model can prove restrictive, with rigid terms limiting the scope of parties to solve problems and pursue the ultimate goals of the contract. Nevertheless, the opposite—unbridled flexibility and a lack of accountability—appears naïve (Van Slyke, 2007). Fortunately, relational contracting—which has been applied and studied more extensively in the private sector, but has until recently received less attention as an approach to public contracting—may offer a middle ground solution (Carter and Ball, forthcoming).

Relational practice is present in virtually every contract to a greater or lesser extent (Macneil, 1974). To some, it is effectively synonymous with an incomplete contract—whichever aspects of the contract are not specified in the formal contract are picked up by relational elements (Scott, 2000). Others suggest that relational contracting is more than mere incompleteness—it says something about the mechanisms through which incompleteness is addressed. For example, Brown, Potoski and Van Slyke (2018) define a relational contract as 'an incomplete contract rooted in trust between exchange partners'.

However, in order to address the shortcomings of a transactional framing, parties will need to proactively seek an alternative approach. With relational intent, parties can pursue features which promote the kind of trust that sustains productive relationships from before the start of the contract and throughout its life. They seek to build explicit shared principles and decision-making forums, shifting the emphasis from what is to be delivered to how parties will navigate uncertainty together.

Increasingly, there is a view that this intent can be taken even further, with a framework for 'formal relational contracting' (Frydinger et al., 2019; 2021). In a formal relational contract, features of relational intent are codified as legally enforceable terms, potentially offering reassurance to those who worry about relying on unenforceable terms when public money is at stake.

Adapting to challenges together

Adopting greater relational intent, informally or through a formal relational contract, potentially offers two mutually reinforcing tools to manage the risks of public contracting: adaptability and collaboration.

At the heart of relational contracts is an acceptance, even embrace, of the inability to completely specify everything that will happen over the course of the contract. Instead, the emphasis is placed on principles and processes which allow risks to be navigated and mitigated, including decision-making structures and values underpinning the ways in which partners will interact with one another. This makes relational contracts more able to adapt to changing requirements, whether as a result of unforeseen internal demands of the contract (Brown et al. 2018), or due to external pressures—an all too familiar experience for public services during Covid 19 (FitzGerald et al., 2021).

Complementing adaptability is a spirit of collaboration between partners. Relational contracting recognizes that, in order to be successful, partners interests need to be aligned around the goals of the contract. Depending on who is involved, there may be a greater or lesser degree of (perceived) initial alignment, and this may change over time (Brown et al., 2007). However, levers such as reputation, the prospect of future business (Brown et al., 2018), or a well-designed payment mechanism (Carter and Whitworth, 2015) can be employed to build and maintain trust over the course of a partnership, ensuring that all parties have an interest in the overarching objectives of the contract being met. This collaborative approach helps to ensure that the flexibility afforded by a relational contract is directed towards the mutual interests of the parties in seeing the contract succeed.

In the case of the Ministry of Defence's Ajax programme, the desired product was incredibly technically complex, and so the need to deviate from the original specification was almost inevitable. Here, the processes articulated in a more relational approach would have offered a clear route for necessary adaptations to be identified and agreed by the parties, while ensuring they aligned with the overarching objective of delivering a capable armoured vehicle in a timely manner. While the contracting approach could not have prevented technical challenges, it could have helped to navigate them more effectively, potentially reducing costly delays to delivery.

Of course, a relational approach comes with risks of its own, including the enhanced risk of opportunism (Spiller, 2008), and so it will not be suitable for every contract. However, in many cases the value of additional adaptability and collaboration will outweigh these risks. Where it does, greater relational intent offers hope that public contracts can better navigate

both endogenous and exogenous risks, and ultimately deliver products and services with better value for money for governments and the people they serve.

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