Outsourcing War:
The Evolution of the Private Military Industry After the Cold War

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Abstract
In this paper, we study the evolution of private military corporations (PMCs), which are hybrid organizations that subcontract field services to sovereign military authorities as well as to others. After the fall of the Berlin Wall in 1989, experienced military personnel sought to redeploy their relationships, skills, and capabilities for profit in PMCs. The industry evolved through several phases during the 1990s that mainly reflected the shifting military priorities of sovereign nations. By the beginning of the 21st century, PMCs had accumulated unique capabilities and had become strategically central to the sovereign military organizations from which they had grown. The analysis demonstrates how hybrid organizations develop and change, and suggests that the formation of hybrids may be a major avenue for institutional entrepreneurship and the formation of new industry structures.
“[W]e have been compelled to create a permanent armaments industry of vast proportions...In the councils of government, we must guard against the acquisition of unwarranted influence, whether sought or unsought, by the military-industrial complex. The potential for the disastrous rise of misplaced power exists and will persist... [I]n holding scientific research and discovery in respect, as we should, we must also be alert to the equal and opposite danger that public policy could itself become the captive of a scientific, technological elite.”

Dwight Eisenhower – January 17, 1961

Eisenhower’s warning about the military-industrial complex was issued in the wake of a transformation in the character of combat. Prior to World War II, the armaments required for combat operations were principally constructed ad hoc in response to wartime demand on a “just in time” model. Armaments were mainly limited to personal weaponry, and particularly handheld firearms. World War II had changed the profile of armaments to large-scale weapons platforms and the massive deployment of transportation equipment, including aircraft, trucks and other types of armoured vehicles. The deterrence strategies of the United States and Soviet Union required the continuous operation of armaments industries rather than the “just in time” model that had been the norm over centuries of recorded combat. Eisenhower was concerned that competition could lead to such technological sophistication in armaments that specialists would be required to govern their deployment. Private corporations with scientific capabilities for armament manufacture might ultimately wield sufficient power to control the fates of nations.

In this article, we argue that private corporations participate in decisions that can influence the fates of nations, but not strictly because of their technological sophistication in the sense that concerned Eisenhower. Some 50 years after Eisenhower’s speech, private
military corporations (PMCs) such as Xe (pronounced “chey;” the successor firm to Blackwater), Sandline and Military Professional Resources Inc. (MPRI) subcontract field services to many different types of organizations, and particularly to sovereign military agencies such as the US Army and the UK Ministry of Defence. Their scale is the subject of considerable controversy as PMCs have come to account for almost 50% of US spending in Iraq (NEED A REFERENCE). The contractual duties of PMCs include combat services, consulting and support operations, and are principally defined in terms of field services rather than technology, although technology (think of data-center services) is involved in PMC activity. In some instances, the capabilities of PMCs make possible the attainment of specific military objectives in the sense that concerned Eisenhower.

The analysis in this paper involves grounded theorizing on the development of PMCs as an industry since Eisenhower’s speech and addresses several questions: Why and how have the militaries of sovereign nations such as the United States and the United Kingdom come to rely on PMCs so centrally? How do today’s PMCs differ from the bands of roving mercenaries that have been involved in warfare through nearly all of recorded history? The analysis sheds light on how hybrids evolve over time. An implication is that hybrids may provide the bridge from predecessor organizations to new, distinctive industry structures: In this instance, today’s PMCs emerged from sovereign militaries first as small, immaterial contractors but grew through time into substantial institutions with distinctive capabilities.

SNAPSHOT: PMCs HISTORICALLY AND PMCs TODAY

As a military general, Eisenhower must have known that reliance on private military services is common in the history of war. Many ancient and medieval governments hired
mercenaries. Greek and Nubian men, for example, fought for the Egyptians as early as the Late Bronze Age. Mercenaries took Jerusalem from the Roman Empire during the Sixth Crusade, and the British hired Hessian forces during the American Revolution (Brauer 1999). Indeed, prior to the late nineteenth century, employment of private militaries was the predominant mechanism for marshalling fighting forces and conscription was rare. Only after the industrial revolution, as military technology advanced, did states begin to conscript and maintain standing armies as a central strategy for protecting national interests. As a result, the language of war reflects traditions related to outsourcing. Singer (2003, p. 24) explains that words such as “freelances” and “companies” emerged originally during the Middle Ages to describe the activities of roaming bands of soldiers for hire. These traditions continued into the 20th century guided by an institutional logic that left private military actors free to operate internationally, subject to state control.

By the early 21st century, PMCs operated very differently. A specific incident illustrates the change. In March 2004, after the ambush and brutalization of four Blackwater employees in Fallujah, US President George W. Bush declared that the United States could not stand idly by (Scahill 2007). The US responded by escalating the Baghdad offensive, which was deemed essential on military as well as ideological grounds as the strength of the US military in Iraq depended critically on the presence of private military contractors (PMCs) such as Blackwater. Had the US not responded aggressively, the authority, legitimacy, veracity, and effectiveness of PMCs would have been stymied, with implications potentially as consequential as conscription in the US. US forces in Iraq were dependent on the operation of PMCs.

Five years later, in 2009, the Iraq Reconstruction Corporation (IRC) had been formed as
the governing body for allocating military and industrial resources toward the rebuilding of the country. Employees of private-military corporations are central to the operations of the IRC. In particular, the employees of firms such as KBR issue directives to deploy members of the 82nd battalion in routine and urgent operations. A different mechanism than predicted by Eisenhower’s “scientific, technological elite” had come to govern some command-and-control decisions by the time of the March 2004 Fallujah incident and the 2009 Iraq Reconstruction Corporation: a decentralized, evolving, partially controlled confluence of actions taken with deliberation by different organizations against varying objectives. PMCs now constitute a legitimized industry that operates by a distinctive institutional logic (Baum and McGahan 2009). PMCs are routinely considered as outsourcers possessing battlefield capabilities that make possible certain kinds of initiatives that could not be undertaken alone by sovereign military organizations.

The timeless challenges of contracting for private military services are well known: a divergence of incentives around the desirability of conflict itself. Put starkly, PMCs profit from conflict, and thus may not pursue peace even when resolution does not compromise the interests of the contracting sovereign (Shearer 1998). Among military leaders, concerns include excessive soldier pay, the risk-taking tied to high-powered incentives, and the involvement of subcontractors in command decisions. The broader public controversy over PMCs centers on the regularity with which they are employed, the centrality of their roles, and the unprecedented limitations on liability they enjoy operating as corporations with enforceable contracts. A scandal erupted in the UK, for example, when the media suggested that the British military regularly relied on PMCs to perform operations in Iraq that were illegal under British
Kofi Annan, former Secretary-General of the United Nations, has decried PMCs and famously declared that they would never be relied upon by the UN – even as member nations such as the United States and the United Kingdom relied upon them routinely. Despite these concerns, proposals to license and regulate PMCs have been rebuffed out of concern that regulation would further legitimize their activities.

For this analysis, we define PMCs as incorporated organizations that offer battlefield services for hire and that take as their customers – at some points in time although not in every instance – sovereign military authorities. Although PMCs remain a relatively small segment of the total military-industrial complex, they now constitute a major industry. PMCs comprise large transnational enterprises including DynCorp and MPRI with uniformed military ranks, doctrine, discipline, and capable of providing – on short notice – companies of commandos and battalions supported by combat helicopters and fighter jets. Most PMCs are small, however, operating as virtual companies that rely on databases of qualified personnel and specialized subcontractors on a contract-to-contract basis.

There have been several attempts create typologies of modern PMCs, of which Singer’s (2003) three-part classification is most comprehensive. Providers contract for services at the front of the battlefield, engaging directly in combat either as line units or specialists (e.g., pilots) and/or direct command and control of field units. Consultants contract for advisory and training services integral to the operation and/or restructuring of an armed force. They offer strategic, operational, and/or organizational analysis but do not operate on the battlefield. Support firms specialize in secondary or noncore military services, including nonlethal aid and assistance, logistical and technical support, supply and transportation. Support firms permit
sovereign forces to concentrate on the primary task of fighting.

Table 1 gives the distribution of PMC operations by type and region from 1967 to 2006. [NEED TO EXPLAIN THE UNIT OF ANALYSIS IN THE TABLE AND HOW/WHETHER MULTIPLE CONTRACTS ARE REPRESENTED AS ‘OPERATIONS.’ SEEMS UNNATURAL THAT THERE ARE NO PROVIDER OPERATIONS FOR IRAQ GIVEN IRC SITUATION DESCRIBED EARLIER. IS EACH CONTRACT AN OPERATION OR IS EACH CONFLICT AN OPERATION WITH THE POSSIBILITY OF BEING CLASSIFIED MULTIPLE TIMES ACROSS TYPES? ALSO SHOULD EXPLAIN WHETHER ONE FIRM COMMONLY PROVIDES ALL 3 TYPES OF OPERATIONS.] As the table shows, the provider segment is relatively small. For every provider operation there were roughly two consulting and three support operations. Indeed, the number of major combat operations that PMCs have undertaken is limited, and few existing companies are willing either to engage directly in combat or to admit to having done so.¹ Much more common and widespread are consultant and support operations.

*Insert Table 1 about here.*

There is, however, variation across regions, particularly among provider operations, the vast majority of which were deployed in Africa. Consulting operations were more prevalent than support operations in Asia and the Americas, while support was the most common type of PMC operation in Europe, Russia, and the Middle East (particularly in post-9/11 Iraq). PERHAPS NOTE THAT KBR IS LARGEST PROVIDER IN IRAQ AND INDICATE WHETHER/HOW IT IS CLASSIFIED AS CONSULTING OR SUPPORT OPERATION OR BOTH. The intensity of PMC operations also

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¹ The most infamous provider PMCs, Executive Outcomes and Sandline, ceased operations in 1999 and 2004, respectively. Many of their affiliates in South Africa (e.g., Ibis Air, Lifeguard) and Angola (e.g., Teleservices, Alpha 5) also disbanded, as have other early provider PMCs that engaged in combat-related operations (e.g., Israeli firms, Silver Shadow and Levdan).
varied by region, with Africa and Europe exhibiting more operations per conflict than other regions except for post-9/11 Iraq, where the frequency, intensity, scale and scope of PMC operations have been greatest by far.

Today, PMCs are deeply involved in major inter- and intrastate conflicts and are the subject of intensive public debate. After the 2004 Abu-Ghraib prison scandal illuminated interdependencies between US military operations and PMCs in Iraq, the popular media extensively reported on the involvement of PMCs in the conflict. More recently, when it became apparent that US military contracted two PMCs to provide combat training to Georgian Special Forces commandos in the months leading up to Georgia’s August 2008 military assault in South Ossetia, the role of PMCs as a regular facet of US military operations became even clearer. Controversy over the involvement of PMCs – and the reputation earned in particular by Blackwater – led the government of Iraq to ban Blackwater from the country in January of 2009, although this approach may ultimately prove ineffective as the company was immediately disbanded and reconstituted under a new name. The tide of public opinion has reflected a range of conflicting concerns, including fundamental questions about PMC adherence to international standards for warfare, and the fairness of differentials in compensation paid to PMC-employed and sovereign-employed soldiers for similar duties. Resolving questions about whether and how to control PMCs requires a detailed understanding of how they have emerged, and why and how they operate in tandem with large hierarchical institutions such as sovereign military forces.

**TODAY’S PMCs AS HYBRID ORGANIZATIONS**

PMCs are archetypical of the hybrid form of organization as they are specialized
geographically or by function, and because they accept assignments that would otherwise be performed or worked around by the hierarchical organizations whose interests they represent. Williamson (1991, p. 2) explains:

“... [T]he hybrid mode is located between market and hierarchy with respect to incentives, adaptability and incentive costs. As compared with the market, the hybrid sacrifices incentives in favour of the superior coordination among the parts. As compared with the hierarchy, the hybrid sacrifices cooperativeness in favour of greater incentive intensity.”

While transaction-cost theories are as yet developing on the nature of hybrids, five major constructs have emerged as central to their characterization. Williamson (1991) established that hybrid organizations (separate from hybrid transactions) operate under 

*incentive mechanisms* and *administrative controls* that are distinct from those in markets and hierarchies. In later work, Williamson (2005) sees hybrids as discrete forms of organization with unique characteristics that separate them from markets and hierarchies. Building on his (1999) paper, he suggests that hybrids may employ mechanisms of *adaptation and coordination*, particularly for dealing with probity hazards, that are distinct from those of markets and hierarchies. In an important survey, Menard (2004) discusses *bilateral or multilateral dependency* built on *asset specificity* as a defining characteristic. He identifies the dimensions of asset-specific investment across transaction partners as the pooling of resources, contracting, and competition.

**Incentive systems.** The intensity of PMC incentive systems is significantly greater than those provided through the traditional hierarchical arrangement of conventional military employment. Retired US army personnel have actively sought out employment from PMCs for
duty in Iraq as a lucrative alternative to accepting a voluntary commission in the US Army. The reputation of PMCs is made on effectiveness in achieving objectives, even by taking risks or incurring costs that would not be acceptable to conventional military organizations. For example, the four Blackwater personnel who drove into Fallujah on that fateful day in March 2004 were deployed on a reconnaissance and recovery task that would not have been executed with as few personnel or equipment under conventional US military procedures.

PMCs are essential precisely because they can perform functions or in geographies where conventional military activity is not possible, timely or efficient. Executive Outcomes became so notoriously effective at the objectives that it pursued that it ultimately disbanded precisely because its reputation became an anchor on the organizations that sought to contract with it. The terms of ‘contract law’ in PMCs are often informal rather than only formal – particularly when the PMC is engaged to challenge the sovereign authority of an incumbent government. Under these circumstances, the national rule of law may be precisely the subject of conflict.

PMCs often perform better than the market in blunting incentives sufficiently to assure coordination both within the subcontracting firm and between the subcontractor and the hierarchical partner. Imagine that a government such as Angola had sought to hire each of the soldiers employed by Executive Outcomes on the open market. The Angolan government would have had to assure compatibility in the training, command structure, skill base, communication systems and leadership functions of the hired individuals. An advantage of this arrangement according to Williamson’s (1991) theoretical argument would have been each

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2 PMC employees can earn 5-15 times more than a US soldier; the CEO of a large PMC can earn 10-100 times more than a four-star general in the US Army.
individual's high-powered incentive to perform consummately. Yet the tasks of coordination would have been daunting, especially for a government already strained to the limit in managing its sovereign military. The viability of hiring retired South African soldiers – once foes of the Angolan army in the conflict region – would have been at issue.

Thus, contract law in the form of arbitration or litigation may not be required to achieve high-powered incentives. Rather, reputational capital, developed over time as the PMCs performed missions of various types and accumulated specialized assets of differing kinds, may have been sufficient to assure the strength of incentive systems as compared with hierarchical organizations. Similarly, the ability of PMCs to coordinate the deployment of specialized assets, especially in a controversial assignment where historical of conflicts of interest would have stymied market mechanisms, permits PMCs to achieve greater incentive compatibility than is available through markets.

**Administrative controls.** Williamson (1991) indicates that the hybrid form offers superior administrative controls to markets but weaker administrative benefits than hierarchies in the accomplishment of a task. The history of PMCs offers reflects his analysis in two major ways. The first is that the mechanisms of administrative control may be much broader than only formal organization systems: the culture of zealfulness – of passionate adherence to mission – may be even greater in some PMCs than in military organizations. Second, the strength of the administrative controls may be enhanced in PMCs as compared to conventional military organizations both as a result of this passion but also because high-powered incentives can be embedded within hierarchical structures to create administrative benefits without the sacrificing of incentive alignment.
The story of PMCs is, in many ways, a tale of passionate commitment and ideological zeal. The generals that serve as the chief consultants at MPRI have cultivated skills as negotiators precisely because of their personal preferences to avoid armed conflict whenever possible. Providers of support services are generally tied ideologically to the missions that they pursue – to the point where their co-specialization with the purchasers of their services is largely shaped by the emotional capital. Providers of ground combat forces are also often committed ideologically to the cause of their contractors, but are especially renowned for their commitment to the ideals of military discipline and the rigors of military life. The discharged veterans employed by PMCs demonstrate by revealed preference their predilection for the service, and while little comprehensive information is available, anecdotal evidence suggests that some of their discharges may have been encumbered by controversy. Thus, while the conventional customs, rules, command structures, training, and specialization of military hierarchy mark the formal administrative systems of PMCs, making them at least comparable to hierarchy on this dimension of governance, the intensity of commitment to the culture of military life renders administrative controls even more potent in PMCs than in hierarchical military organizations.

Thus, the performance of PMCs as hybrids may not be compromised on either adaptability or coordination. Indeed, the controversy over PMCs suggests that PMCs may accumulate successes without public debate or administrative intervention to discern unintended or perverse consequences that arise from their success. Sovereign governments and multinational corporations, for example, may turn to PMCs to perform tasks that are difficult, specialized, controversial and otherwise problematic, and seek to coordinate with
them based on the achievement of particular outcomes rather than on PMCs’ adherence to conventional processes. The current debate over proper regulation of PMCs points to opportunities for restricting performance rather than for enhancing it. Overall, our analysis suggests that Williamson’s framework for evaluating governance is incomplete. Incentive intensity, administrative controls, adaptation and coordination do not appear compromised in the hybrid form represented by PMCs. Rather, each facet of the governance system associated with contracting is tied to the factors that gave rise to the asset specificity, probity hazards and uncertainty that led to the emergence of PMCs as hybrids.

Adaptation and Coordination. In later work, Williamson (1999) emphasized the commitment of the executing parties to achieve consummate performance, which he discussed in terms of “probity.” In the case of PMCs, ‘probity’ refers to the loyalty and rectitude with which the commitment to a client’s objective is discharged. Williamson (1999) introduced the concept of probity to emphasize the specificity of some extreme transactions including sovereign tasks: “foreign affairs, the military, foreign intelligence, managing the money supply, and, possibly, the judiciary” (1999, p. 321). In such transactions, the sovereign is highly dependent on the professional excellence of the contractor. Failure to achieve agreed-upon objectives may result very large losses for the sovereign. Transactions characterized by probity hazards thus involve stakes well beyond the parameters of the transaction itself, and distinguished by “their needs for loyalty (to the leadership and to the mission) and process integrity” (Williamson 1999, p. 324). Remedies to probity hazards include loyalty, professional excellence, adherence to principle, procedural safeguards, and social conditioning (Williamson 1999, p. 323-4).
Probity hazards are extensive in transactions for private military services for many reasons. First, in combat situations, the lack of loyalty and accountability of PMCs may be a central facet of their appeal: they possess capabilities and a willingness to perform duties that branches of the national military cannot perform (Singer 2003). Through probity, some PMCs perform operations outside the scope of conventional military operations either because of their riskiness or their policy implications. PMCs are not bound by the same constraints to authority as conventional forces, and the absence of constraint enables heroic, passionate or even zealous adherence to mission. Second, reputational capital is tied to both PMCs and particular individuals. To the extent it is tied to the corporation, PMCs attenuate the consequences for individuals of probity violations. This is particularly true when PMCs act under the limitations on liability afforded them as corporations. Third, contracts themselves may be difficult to interpret and may not stipulate contingencies that would otherwise guide decisions in the field.\(^3\) Responding to private incentives rather than with “loyalty and rectitude” (Williamson 1999), subcontractors may make decisions differently from those that would be made by the sovereign’s military forces. In some instances, this may mean that PMCs do not pursue objectives with commitment, as was famously the case when the Condottieri in Xth century Italy fought against mercenaries in vast numbers, with more than 10,000 troops on each side [CHECK SPECIFIC REFERENCE]. Because all of the troops were hired mercenaries on both sides, only a few casualties were incurred as neither side fought with intensity. Fourth, the “loyal and righteous” choice may be difficult to discern because of the multiple facets of the

\(^3\) The presence of probity hazards creates a transactional environment that favors renegotiation. For example, in France, 56% of defense procurement contracts are renegotiated, and such renegotiations cause an average price increase of 4.6% per contract, with some increases reaching 30% (Oudot 2007).
interests of parties to private military contracts. The complexities of the sovereign’s interests alone may not be identified, and confusion may be compounded as field personnel also consider the interests of their employers. Finally, intertemporal movement in interests may further complicate a field officer’s choices. Acting with integrity may mean something different each day. Slow movement of information into the field may thus exacerbate probity hazards.

According to this logic, the probity hazards associated with sovereign transactions expose contracting parties to the potential for poor adaptability and coordination. Yet PMCs are hired precisely because of their abilities to adapt and coordinate more readily than within hierarchical organization or through markets. Probity is associated with greater flexibility and learning than under other transactional forms. Thus, whereas Williamson (1991) anticipated compromises in performance with markets on adaptability and compromises with hierarchies on coordination, the analysis below suggests that PMCs as hybrids deliver both more effectively. For example, after brokering a 1994 agreement between Muslim and Croat factions in Croatia to join forces against Serbian aggressors, the Pentagon referred the Croatian Defence Minister to MPRI, and with US government approval, the company signed a contract with the Croatian government in January 1995 to supply a team of 14 military advisers led by retired US general John Sewall to train the Croatian army into a NATO-style force that could help maintain regional stability. The MPRI contract effectively circumvented a 1991 UN arms embargo (which the US had approved in the Security Council) that prohibited the US from directly selling arms or providing military training and advice to any of the warring parties (Singer 2003).

**Bilateral or multilateral dependency.** A critical facet of the hybrid form of organization is “bilateral or multilateral dependency” in which the buyer and the seller of services are
mutually interdependent. In PMCs, consultants and support firms operate exclusively in tandem with other interests in pursuit of a unified objective. Providers often work in tandem but sometimes work alone. Even in working alone, however, they may exhibit bilateral dependency as when Executive Outcomes was called upon because of the experience of its personnel in combat against União Nacional para a Independência Total de Angola (UNITA) rebels in Angola and Namibia, or when MPRI was contracted in Bosnia because of its experience against the Serbs in Croatia.

In his analysis of transaction governance, Williamson (1991) relies on rules of contract law to contrast how the administrative control systems of markets, hybrids and hierarchies differ. Litigation and the threat of litigation are seen as the principal mechanism for contract enforcement between parties that created their relationships through market exchange. Hybrids, in contrast, rely on arbitration as the mechanism of enforcement both because of the complexity of the mutual interdependency and because of the higher states associated with the conflict that can arise from litigation. Forbearance is characteristic of hierarchical governance: employees, for example, typically must accept the authority of management decisions when disagreements arise, or suffer consequences in their promotion and career prospects, personal reputations, and compensation. Williamson (1991) emphasizes that these differences in contractual enforcement are integral to the nature of transaction governance.

The case of PMCs, which otherwise definitively demonstrate the characteristics of hybrids, suggests that Williamson’s (1991) analysis may be incomplete. The contracts drawn between PMCs and their clients such as sovereign governments are rarely enforced via arbitration, perhaps because of confidentiality requirements. While litigation sometimes
occurs, its subject is rarely the terms of a contract per se, but rather the legality or legitimacy of the contracted-upon service. Forbearance is likely common, and yet the principal mechanism to assure compliance is reputational considerations.

Reputation works in several ways. First, of course, a PMC’s reputation for fulfilling the terms of its contract has a direct influence on its relationship with its client, and may make further agreements more or less likely. Second, the PMC’s reputation affects its effectiveness in the field. Local combatants may be intimidated, or negotiating parties may be assuaged, for example, by participation of a PMC with a reputation for effectiveness in domain of operations. Finally, the PMC’s reputation spills across potential contractors and prospective employees, and may ultimately generate additional revenue or cost-reduction opportunities for the firm. In the historical analysis presented below, we discuss how PMC reputation in a broad sense has been complicit over time in the evolving legitimacy of military outsourcing.

**Asset specificity.** Asset specificity in the form of human, organizational and physical capital is replete in sovereign military transactions (McDonough 2005), which Williamson (1999) identifies as a particularly extreme case of asset specificity. The equipment, skills and resources necessary for military activities are not normally useful in other applications (although markets for personal security services, for example, are currently expanding rapidly (Singer 2003)).

**Human capital** among PMCs is strikingly strong. The founders and leaders of PMCs typically have backgrounds in the sovereign military. Eeben Barlow of Executive Outcomes, Tim Spicer of Sandline International, David Walker of Control Risks Group, Alistair Morrison of Defence Systems Limited, and Vernon Lewis and Carl Vuono of MPRI, for example, were not only highly skilled and experienced military leaders, but also experienced in the regions in which their firms
were subsequently active. PMC personnel are often former members of elite Special Forces units, with training in reconnaissance and tactical analysis of intelligence, accustomed to interacting with foreign nationals, and offering a high level of experience, professionalism and discipline.

**Organizational capital** among private providers is so specialized to the military that PMCs market their services by direct reference to the experience of their principals in military service, especially in elite forces. MRPI, for example, boasts “more generals per square foot than the Pentagon.” Another source of organizational capital is the PMC’s experience and reputation for effectiveness in particular domains or regions of operations. Importation of a sovereign military client’s chain of command into a PMC may facilitate its effectiveness in hiring, training, deployment and coordination with sovereign forces (Singer 2003).

**Physical capital** associated with military applications principally includes arms and transportation equipment, although many other forms may also arise. Basic physical capital is typically available on open markets, often inexpensively (Singer 2003). Advanced equipment, definitive in field operations, such as specialized helicopters, night-enabled firearms and armoured transport vehicles may be more difficult to procure and expensive, however.

**Relational and reputational capital,** identified by Baker et al. (2002) as “informal agreements sustained by the value of future relationships,” are a central facet of the connections between PMCs and their clients. Relational capital – the accumulated stock of informal capital struck through contracts over time – is a central facet of the profile of effectiveness for PMCs. As PMCs developed relationships with sovereign governments, they came to embody specific knowledge (in the sense of Kogut and Zander 1993) that led them to
become preferred partners for sovereign authorities, and particularly the United States and Great Britain, and that also led to the accumulation of specific skills for performing functions in particular geographic and/or technical areas that made them essential to combat operations.

At the same time, the firms developed reputational capital that both enhanced and stymied their effectiveness in writing and executing contracts (Klein Crawford and Alchian 1978, Klein 2007). This reputational capital was embodied in (a) the joint actions of employees that worked together in teams both within PMCs and across PMCs and sovereign authorities, (b) the trademarks, identifiers and brands of PMCs and (c) the detailed knowledge of combatants of PMC operations in conflict settings (i.e., in Angola, the approach of Executive Outcomes became legendary).

Relational and reputational capital each became central to the effectiveness of hybrid organizations in effecting transactional outcomes that were not achievable through either market or hierarchical forms. Thus, transaction-cost dynamics were not only influenced by these hybrids, but transactional possibilities were defined in part by their capabilities. Thus, command-and-control opportunities were defined by the capabilities of these hybrids.

The implications for transaction governance of each of these types of capital are complex. On the one hand, asset specificity tends to create transactional hazards that may make PMCs vulnerable in contracting. On the other hand, large numbers of both sovereigns and non-sovereigns seek to contract for private military services, and trust can develop between parties even under incomplete contracts (Mayer and Argyres 2004; Zhou and Poppo 2008). In these negotiations the specialized capabilities of individual PMCs may be particularly valuable in the circumstances of a localized conflict. The value of a PMC’s capabilities also may
reflect the simultaneous resolution of multiple transactional negotiations. For example, the engagement of a company such as Executive Outcomes for a localized operation may be perceived as imperative if the opposing force in the conflict has capabilities that only Executive Outcomes has successfully combated in the past.

THE EVOLUTION OF PMCs AFTER THE COLD WAR

How did PMC governance evolve into the hybrid form subject to bilateral dependence despite probity hazards? How did PMCs create command-and-control opportunities that previously had not been available to sovereign authorities, and how did they come to be charged with command-and-control responsibilities in Iraq and Afghanistan? Our principal conclusions rest on the assertion that the dramatic increase in size and change in character of the PMC industry since Eisenhower’s presidency reflects several transitions, which ultimately reflect shifts in underlying social, cultural, political and economic conditions.

During the Cold War, the level of co-specialization of PMCs with the organizations they served was substantially lower than it is today. A close identification of particular PMCs with the military in their host countries – such as now exists between the US Department of Defense, KBR, and MPRI, for example – was rare. Private military organizations competed openly in factor markets for equipment and skilled personnel, competed in product markets for assignments, and operated on a small scale that limited the dependence of contracting agencies upon them.

As we chronicle below, the explosive growth of the PMC industry reflected shifting historical conditions after the end of the Cold War, which first increased the supply of the
equipment and trained soldiers employed by PMCs. The increase in the supply was driven by factors such as high unemployment among former military personnel and availability of used armaments available at salvage-value prices from former Soviet Republics reeling from corruption, failing infrastructure, and economic insecurity (Remnick 1994; Singer 2003), and out-of-work soldiers inspired by rallying cries for democracy and freedom (Gaddis 2005). At the same time, the location, conflict scale, conflict intensity and the character of strategic decisions all shifted, altering fundamentally the conditions for military services contracting.

The demand for PMC services subsequently expanded significantly with the rise of intrastate conflicts, especially in Africa. The absence of formal and informal constraints meant that PMCs were typically able and willing to become involved directly in the intrastate conflicts of developing nations that began as the Cold War ended. Demand was influenced by changes in the nature of combat operations and the decline in developed nations’ willingness to intervene in such conflicts. These events motivated the formation of PMCs with resources and capabilities comparable to and compatible with those of advance Western military forces. Thousands of unemployed soldiers signed lucrative contracts with PMCs for deployments at short notice into conflicts worldwide. Others founded their own companies. Many of these soldiers were trained in large sovereign military forces such as those in the US, South Africa, and Britain. Later, as interstate conflict re-emerged after 9/11, PMCs have been engaged to execute national foreign policy in a manner consistent with the ideology of privatization, and to limit the deployment of sovereign forces necessary in foreign conflicts.

Subcontracting thus emerged as an efficient mechanism for allocating military capital to those with the greatest demand for it. As we argue below, growth in the supply of and demand
for PMCs after the end of the Cold War led to their hybrid transactional form rather than to their integration within sovereign agencies such as the US Department of Defence or British Ministry of Defence. PMCs operate in a complex agency relationship with sovereign authorities because of difficulties of incentive alignment, task specificity, capability development, and performance measurement, among other things. Ultimately, however, the evolution of PMC governance reflects broad institutional trends including privatization, globalization, and the legitimacy of alignment between corporate and state interests.

**Cold War Era.** In the years immediately after World War II, the logic of the Cold War dominated military activities. Clear authority, centralized decision-making processes, coordinated resource deployment, well-defined roles, and the secure passage of information through the command-and-control hierarchy were all facets of effective military post-war reconstruction and intelligence. Military capability centered on preparation for high-intensity, interstate combat based on highly technical equipment and skills (McDonough 2005). Sophisticated assets such as long-range missiles were located strategically and governed in ways that would facilitate their rapid deployment if necessary. Land, sea and air operations developed based on highly technical platforms for deploying resources on a massive scale. Yet the incidences of their deployment were relatively rare in comparison to the scale of operations (McDonough 2005). Military organization was designed to deploy these technologies, if they were to become necessary, in highly coordinated responses on a vast scale. Thus, organizational performance was defined principally by coordination rather than by adaptation; incentive structures encouraged adherence to well-defined lines of authority; and administrative structures became legendary for their bureaucracy. The Cold War regime was
thus associated with an extraordinary strengthening of hierarchical, sovereign military
institutions, as would be suggested by Williamson (1991).

Some of the most important military assets that developed during the Cold War,
particularly weapons platforms and transportation systems, rested on technologies that had
been developed in the private sector. Before WWII, the primary role of private contractors
such as Booz Allen Hamilton and Vinnell Corporation was to provide logistical support such as
transportation, medical services, and provisioning. During the Cold War, the increasing
technical complexity of military equipment and hardware led the military to rely increasingly
and to develop close relationships contractors such as DynCorp, Northup Grumman, and SAIC
as technical specialists working side-by-side with deployed military personnel. Throughout this
period, military subcontracting for interstate conflict tended to be highly specialized and
technical, involving the provision of circumscribed sets of services that were deeply embedded
within sovereign military agendas. Clear lines of authority, rigorous training processes and
highly centralized decision systems were vital to subcontracted military processes. The
introduction of sophisticated information technologies into field operations accentuated the
complexity and diversity of military hierarchies by enabling coordination and communication at
many levels: geographic, cross-functional, and inter-organizational.

During this period, the first corporate ventures formed with the express purpose of
selling military services began to appear. Among them was WatchGuard International,
established in 1967 by Sir David Sterling, founder of the British SAS. Employing former British
SAS personnel, the company’s mission was to safeguard British interests by providing military
services and advice, security for heads of state, and Special Forces training to developing
countries, particularly in Africa and the Middle East. It attempted to formalize its relationship with the British government, which was known to contract with private forces to support its foreign policy and Colonial interests, by committing to providing its services only with government consent (Kinsey 2006). By 1970, however, it was clear that the formality of the relationship made government deniability of covert actions undertaken on its behalf by WatchGuard impossible. The organization has achieved a reputation that barred some kinds of sovereign contracts despite – and even perhaps as a result of – the effectiveness of Watchguard in executing these kinds of contracts. Seeking profits elsewhere, Watchguard sought and found other customers in the multinational corporations (MNCs) that sought to develop in the same geographic areas where the company had operational expertise. Thus, the organization’s reputation and other specialized assets were transferred into a new market.

This pattern emerged as characteristic for PMCs. Initially seeking contracts from sovereign military authorities, successful firms often later broadened their customer bases to include MNCs, particularly those in natural resources extraction industries and/or operating in developing countries. These companies sought out PMCs to provide solutions for their security and intelligence problems, which in turn encouraged the formation of additional PMCs structured as corporate entities to limit their liability (Kinsey 2006). In the UK, these included Control Risks Group, founded in 1975 by former British SAS officer, Major David Walker, and Defence Systems Limited, formed in 1981 by another former SAS officer, Colonel Alistair Morrison, and in the US, Kroll, established in 1972 by Manhattan Assistant District Attorney Jules B. Kroll. Although such firms also took on government contracts to train foreign militaries, this fact was not widely publicized to avoid media scrutiny and public opposition (Kinsey, 2006).
Thus, even before the end of the Cold War, a precedent had been established for the formation of PMCs reflective of and symbiotic with sovereign military hierarchies. These firms implemented administrative systems designed to meet the particular requirements of the large organizations they served. Incentive systems tended to reflect the pay schemes of the military except for owner-founders, who quickly came to profit, often handsomely, from their ownership shares. Performance was judged principally on criteria that emphasized effective coordination with the large organizations that were the principal buyers of PMC services.

Post-Cold War Era: Berlin to Mogadishu. The end of the Cold War, marked by the fall of the Berlin Wall in 1989 and the disbanding of the Soviet Union in 1991, brought deep cuts in military budgets and an end to massive permanent troop deployments in Europe, the US, and the Soviet Union. Deployments also withdrew from African and Middle Eastern countries as well as from republics that broke from the Soviet Union in December 1991.4 This downsizing was reinforced by the economic ideology dominant during the Reagan-Thatcher era, which, based on the idea that the market could deliver public services more cost efficiently, saw many government functions, from transportation to power generation to prisons, privatized. In many countries, downsizing was followed by armed forces professionalization, and replacement of conscripted forces with more expensive all-volunteer forces, increasing further demands for leaner and less expensive armed forces.5

Thus, the first consequence of the end of the Cold War was the unemployment of large

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4 US military troops, for instance, declined from 2.1 million in 1989 to 1.3 million in 2001 (US Department of Defence, Directorate for Information Operations and Reports). Other NATO countries conducted similar reductions. The Soviet Union/Russia declined from 5.2 million in 1987 to less than 1.0 million in 2001. Worldwide troops fell from 11.9 to 6.0 million in developed nations and from 17.0 to 14.7 million in developing nations (U.S. Department of State).

5 The South African Defence Force (SADF) also downsized at roughly the same time as the conflict waged in Angola and Namibia ended and the two-year National Service requirement phased out.
numbers of trained military personnel, many of whom had specialized technical skills, and all of whom shared a familiarity with the administrative culture and systems of the sovereign militaries in which they were trained. This massive wave of unemployment was accompanied by the disposal of large caches of small armaments, specialized transportation equipment and armed vehicles onto open markets. Surplus military equipment also became available with the de-militarization of Europe and the collapse of the Soviet Union. Breakaway republics, in particular, eagerly sold former Soviet military assets to obtain foreign currency to bolster their faltering economies, resulting in unprecedented availability of sophisticated military equipment, including the versatile fleet of Soviet helicopter transport and gunship aircraft. Soviet AK-47 assault rifles were available on secondary markets for a few hundred dollars; used tanks and aircraft for a few tens or hundreds of thousands of dollars.

At the same time as the skilled personnel and armaments and equipment became available to form PMCs, a new type of demand for their services began to emerge. Beyond dealing with the new distribution of power, one of the great challenges facing developed nations was to decide how to respond to the civil wars emerging in developing regions that had previously been a battleground of the Cold War. As Figure 1 illustrates, while the threat of interstate conflict declined during the post-Cold War period, revolutionary and ethnic intrastate conflict escalated. These conflicts were particularly prevalent in countries with governments formerly supported by the Soviet Union (e.g., Angola, Ethiopia, Afghanistan, Iraq) or by Western interests (e.g., Rwanda, Congo, Somalia, Pakistan).

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6 Unwanted arms at the end of the Soviet-Afghan war, for example, transformed northwest Pakistan into a regional arms trading center where buyers could choose from Chinese, East European and Israeli arms, as well as stocks of captured Soviet arms (e.g., rocket-propelled grenade launchers and AK-47s), and locally-produced cheaper arms (Phythian 2000).
These new intra-state conflicts differed notably from prior interstate conflicts. Although more frequent, intrastate hostilities were more limited in geographic scale, entailed localized combat between untrained and poorly equipped forces, and so generated fewer casualties than in interstate conflicts. Figures 2 and 3 illustrate the trend in conflict intensity, by region, over the period. As the figures show, the number of conflicts resulting in more and less than 1,000 deaths per year (both military and civilian) increased steadily during the Cold-War, but in the years immediately following the end of the Cold War, conflicts resulting in more than 1,000 casualties fell substantially, while those resulting in fewer than 1,000 deaths continued to rise. Despite their smaller tolls in an absolute sense, the intrastate conflicts were brutal, with combatants frequently disregarding established rules of war, committing atrocities against non-combatants, and precipitating massive humanitarian crises. Quick adaptation to shifting conditions became a hallmark of successful military action in this environment.

These developments revolutionized how Western countries in particular responded militarily. Sovereign deployments shifted away from permanent installations and toward engagement on a temporary, ‘as needed’ basis to represent state interests in interstate conflict and to aid in the de-escalation of intrastate conflicts when they arose. Interventions typically required specialized capabilities in peacekeeping, crisis response, security, forces training, and pre-emptive negotiations as well as, and often rather than, combat. Small deployments were

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7 These new conflicts blurred “the distinctions between war (usually defined as violence between states or organized political groups for political motives), organized crime (violence undertaken by privately organized groups for private purposes, usually financial gain) and large-scale violations of human rights (violence undertaken by states or politically organized groups against individuals” (Kaldor 1999, p. 2). They also blurred boundaries between “internal and external, between aggression (attacks from abroad) and repression (attacks from inside the country)” (Kaldor 1999, p. 2).
the norm with operations highly divisible and ‘contractible’ and with performance often judged on the achievement of military objectives rather than on the execution of functions – an emphasis on adaptation rather than coordination. Timelines for responding to incidents were also relaxed, with many characterized by ramp-up periods of several months or more rather than the hours, days or weeks for planned responses during the Cold War. Flexible, small-scale approaches and transportation became critical to military effectiveness, while massive land-sea-air operations based on permanent troop deployments and highly technical weapons platforms became obsolete (Fredland and Kendry 1999).

Initially, Western nations seemed prepared to engage their downsized militaries cooperatively to resolve regional ethnic and nationalist conflicts and aid humanitarian disasters, for example, launching international interventions in Northern Iraq and the Balkans in 1991 and Somalia in 1992. In this environment, the hierarchical bureaucratic structures essential for the efficient deployment of high-technology weaponry during the Cold War constrained flexibility. The US and the UK were unable to marshal the kinds of detailed, on-the-ground knowledge necessary to succeed in combat operations in these settings. No longer did strategies based on the deployment of state-of-the-art technology succeed. Western troops were neither trained nor equipped for low-intensity civil wars, involving complicated ethical agendas, blurred boundaries between combatants and civilians, and loose military hierarchies.

This became vividly evident during an October 1993 incident in Mogadishu, Somalia, where US forces, relying on technically sophisticated armaments but little local knowledge famously and tragically failed in a mission to secure a strategically important area of the city, resulting in the deaths of 18 US military personnel and wounding of another 73. Mogadishu
marked a turning point. What had become clear was that type of specialized knowledge most relevant to the success of military missions in intrastate warfare was detailed understanding about local context, issues and capabilities.

**Post-Cold War Era: Filling the Security Vacuum.** With intrastate conflicts multiplying in the developing world, developing nations were hampered by administrative structures that were not designed for the quick, locally tailored responses required to succeed. Sovereign military structures were unable to adapt quickly to changing local circumstances. And the incentives for participation in intrastate conflicts were complicated by unresolved questions about the macro- and micro-political interests of states that had previously defined their objectives under the relatively simpler alliances forged during the Cold War. After Mogadishu, the US, and Western nations more generally, refrained from deployments in regions that were deemed as not essential to their national interests, such as in Rwanda in 1994.8 Instead, they engaged in a policy of active disengagement, arguing for localized responsibility for peace, security, and economic development (Avant 2005).

Unable to define their interests clearly or to mount armies effectively in intrastate conflict, the ambivalence of Cold-War-era sovereign authorities created a vacuum in security and policing in conflict areas. This, in turn, created opportunities for PMCs to contract directly with developing states to provide security details and even combat forces. Thus, for fragile states lacking support from the great powers and unable to field sufficient armed forces to provide security for their citizens, PMCs provided a means of reaffirming political control and some semblance of order. Indeed, as Kinsey (2006, p. 60) notes, it is not surprising under these

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8 In Rwanda, the US expressly decided against spreading its forces too thinly across multiple fronts (US President Bill Clinton later stated his regret for the decision to conserve forces for deployment in Bosnia-Herzegovina).
conditions that “governments decided to employ private forces to fight on their behalf.”

One of the first PMCs to exploit opportunities emerging at the end of the Cold War was Executive Outcomes (EO). EO was founded by in 1989 by Eeben Barlow, former assistant commander of the 32nd Battalion of the South African Defence Force (SADF), with its personnel tending to have the same background. Initially established to provide intelligence training to SADF Special Forces, it began to conduct security and intelligence operations in Angola, Botswana, and Namibia for De Beers and other South African mining companies in the early 1990s, and carried out its first major military operation in Angola in 1993. The company was hired by Anthony Buckingham, senior advisor to several North American oil companies, to recapture and defend oil reserves at Soyo from UNITA rebels. EO accomplished its objectives with 24 well-trained and equipped troops and three armoured helicopter gunships.

EO’s performance resulted in a $40 million contract with the Angolan government to train and supply weapons to government troops and provide protection against UNITA. Shortly after the contract was renewed in 1994, government troops’ success forced UNITA to sign a peace accord with the Angolan government. Singer (2003) provides evidence that EO’s success led to its control by a group of British-based entrepreneurs (including Buckingham) who established a consortium of related military companies (e.g., Alpha 5, Bridge International, Saracen International, Shibata Security, Teleservices International, Lifeguard, Ibis Air) and mineral enterprises (e.g., Branch Energy, Heritage Energy, Ranger Oil, DiamondWorks).

EO’s success in Angola convinced the government of Sierra Leone, in collaboration with Branch Energy which had significant mineral interests in the country, to enter into a $35 million contract with EO in April 1995 to provide military support and advice to its army. Since 1991,
Sierra Leone had sought military assistance from Britain to contend with the Liberian-backed Revolutionary United Front (RUF) with which it was embroiled in a deadly civil war. Although its ties with Britain were strong (the British Navy used Sierra Leone’s capital city, Freetown, as a staging port during the Falklands War), the British Ministry of Defense declined the request. At this point, government officials and army officers turned to PMCs for help.

Initially, Channel Islands-based Gurkha Security Group (GSG), comprised of former British Army Gurkhas, was contracted. Despite their fierce reputation, GSG refused to accompany the army in operations and failed to improve the security situation. Then, in February 1995, 20 Gurkha troops and their Canadian commander were killed in a RUF ambush; the remaining Gurkhas left shortly afterward (Avant 2005). When EO arrived in May 1995, RUF forces were within 20 kilometres from Freetown when EO arrived. By January 1996, EO had secured the capital city, regained control of the country’s diamond fields, and destroyed the RUF headquarters (Kinsey 2006). Former UN diplomat, Tejan Kabbah, was elected president the following month, and he signed a peace agreement with the RUF in November 1996. A key provision of the agreement inserted at RUF’s request was that EO would leave the country by January 1997. Unfortunately, in May 1997, with support of the army Kabbah had threatened to downsize, Major Paul Koroma led a successful coup and joined forces with the RUF.

Thus, PMCs were not only integral militarily to developments in the region, but through reputation, relationships and allegiances had a major impact on economic and political activity. A fundamental turning point had occurred, with PMCs generating command-and-control options through their relational capital and detailed organizational knowledge. Military options that had not previously been conceived became possible.
Post-Cold War Era: Implementing Foreign Policy. By the mid-1990s PMCs had established themselves as viable commercial ventures and carved a niche for their services among leaders of developing countries facing internal political crises and threats to their authority. Western nations benefitted greatly from these arrangements, which, by improving security in developing regions, helped protect their commercial interests and maintain the flow of key resources. These benefits were not lost on military leaders, which expressed little opposition to PMCs because their activities limited the need to put their own troops in harm’s way when national interests were not clearly at stake (Kinsey 2006).

Along with the emphasis on force reductions and privatization to cut costs, these benefits appear to have prompted the US government to begin using PMCs to promote its foreign-policy agenda. PMCs enabled governments of developed nations such as the US to succeed in conflicts by reducing the engagement timeframe and even by avoiding troop deployment altogether. When Western countries did become embroiled in unpopular conflicts, PMCs could serve as ‘force multipliers’ enhancing the effectiveness of sovereign forces by freeing them to focus on core activities. PMCs also enabled governments to circumvent constraints on military activity, either self-imposed (e.g., Congressional limits on troop deployments in the US) or by international agreement (e.g., UN embargos).

The US reliance on PMCs reached a turning point with interventions in Bosnia, Croatia, and Angola in 1995. Military Professional Resources Inc. (MPRI) was founded in 1989 by retired US Army General Vernon Lewis, and joined in 1993 by General Carl Vuono, who, as US Army Chief of Staff from 1987-93, oversaw operations in the first Gulf War. MPRI was established to

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9 As well as MNCs seeking protection for their oil and mineral extraction facilities and reserves.
provide defence and security training, organizational expertise, and leadership for US interests. With US government approval, the company signed a contract with the Croatian government in January 1995 to train an army into a NATO-style force that could help maintain regional stability vis-à-vis Serbia. The MPRI contract effectively circumvented a UN embargo prohibiting provision of military support to any of the warring Balkan countries, enabling the US to pursue its policy of creating a counterbalance to Serbia in the region.

In August 1995, the Croatian army broke a UN cease fire, launching an offensive that provided the first major victory against the Serbs in the Yugoslav civil war. The triumph had a major impact on the outcome of the war as it led to the signing of the Dayton Peace Accords in November 1995 (Singer 2003). As part of that accord, MPRI signed a similar contract with the Bosnian government. Also in 1995, as part of a US government deal with Angola, MPRI won a contract to train a Rapid Intervention Force (RIF) – a contract previously held by EO. Since then, MPRI has worked extensively for the African Crisis Response Initiative, a US program to improve the military strength of the African countries of Senegal, Malawi, Benin, Mali, and Kenya.

Although outsourcing is not as deeply rooted in British as US military history, Britain too began to deploy PMCs in support of its foreign policy during the mid-1990s. Consistent with its covert use of private force to support its interests during the Cold War, this involvement was not as widely evident as in the US. As Kinsey (2006, p. 64) explains, the British Foreign Office had a list of companies deemed competent to carry out specialized or general military training. If a politically sensitive request for British military assistance were received, the Foreign Office might ask one of these PMCs to take it on.

Exemplary of PMC activity in this domain was Sandline International’s contract in 1997
to assist Sierra Leone’s exiled President Tejan Kabbah in his return to power. Sandline was formed in 1996 by Tim Spicer, a retired Lieutenant-Colonel in the Scots Guards and a former EO employee, to supply military and security services to governments and multinational organizations. The contract stipulated the creation of a military force in Nigeria to repel the junta from Freetown and the Kono diamond fields. In addition to enhancing the Nigerians’ combat capability, Sandline was to supply weapons, mortars and ammunition, which it purchased from Bulgaria. In exchange for mining concessions, a group of investors with mining interests in Sierra Leone, agreed to cover the operation’s cost. The operation, which aimed to restore a democratically elected government that would be recognized by the British government, was undertaken with support from the British High Commissioner, senior civil servants, and thus, Sandline executives believed, the approval of the Foreign and Commonwealth Office of Great Britain.

In 1998, however, a UK investigation began into whether the arms supplied by Sandline were in breach of a UN arms embargo against Sierra Leone. Now known as the ‘arms to Africa’ affair, the controversy, which stemmed from confusion over whether the UN embargo applied to the government in exile, resulted in a detailed investigation into allegations that the British government had been complicity in the illegal supply to Sierra Leone through Sandline. This and other investigations, which ultimately cleared Sandline (see Kinsey 2006 for a detailed discussion), were critical to legitimizing British PMCs in combat and military support operations, and to the fostering of a more transparent relationship between the British government and PMCs under its CONDO (Contractors on Deployed Operations) policy, which harmonizes the treatment of contractors’ personnel in areas including insurance and pre-deployment training.
By the end of the 1990s, IGOs (independent government organizations such as the United Nations), and NGOs (non-governmental organizations such as Oxfam) were also coming to rely on PMCs to support their activities because they too found it increasingly difficult to maintain the security of their personnel and to execute humanitarian and disaster relief efforts in conflict and unstable regions. The British PMCs ArmorGroup, Global Risk Strategies and Northbridge Services Group, and the American PMC, Kroll, for example, operate under contract with numerous IGOs, including UN agencies, USAID, the ICRC, as well as a NGOs, including the International Rescue Committee, CARE, and Caritas (Schreier and Caparini 2005).

Throughout this period, PMCs passed tests of their legitimacy and became increasingly common as partners to established multinational organizations. As a result, when the US and British governments did take action in zones deemed of national interest (e.g., Panama, Columbia, Iraq, and Bosnia), PMCs played the role of force multipliers, operating in tandem with sovereign forces. Western nations could thus achieve national objectives without deploying large numbers of civilian troops in unpopular or remote conflicts.

Figures 4 and 5 show the rise and geographic spread of PMCs during the Post-Cold War period. By 2006, more than 200 PMCs were operating on every continent except Antarctica. The figures show that, while the phenomenon of a rising PMC industry was rooted in the 1970s, the number of PMCs increased sharply after the Cold War ended, and even more rapidly after the September 11, 2001 attacks. The figures also show that most PMCs are based in the US, Britain, the Middle East (mainly Israel) and Africa (mainly Angola and South Africa). Their locations reflect the fact that much of the excess military capacity either available or created by the end of the Cold War was concentrated in these countries. Figures 6 and 7 show that the
number of PMC operations also jumped dramatically, primarily in Africa, after the end of the Cold War, and then, even more dramatically after September 11, 2001 in the Middle East.

*Insert Figures 4-7 about here.*

**Post-Cold War Era: 9/11 to Iraq.** Since the September 11, 2001 attacks on the World Trade Center and the Pentagon, the number of PMCs working for the US Departments of State and Defense increased notably, escalating the interdependence of US military forces and PMCs. Consider, for example, that during the first Gulf War, the ratio of military troops to contractors was 50:1. By the second Gulf War it reached 10:1, with much of this increase resulting from contracts for the provision of military security and intelligence services by PMCs (Singer 2003).

Increases in the raw numbers of PMC personnel were accompanied by a dramatic rise in the range of activities outsourced to PMCs – with the controversial and unprecedented subcontracting of some command-and-control decisions: The US military relied on contractors in Iraq to run the Combined Air Operations Center, to target precision guided missile systems, to man biological and chemical detection systems, to operate unmanned Predator and sophisticated Guardrail surveillance aircraft, to secure communications systems, and to operate the 4th Infantry Division’s digital command-and-control systems (Isenberg 2004). Camp Doha in Kuwait, which served as the launch-pad for the US invasion in Iraq, was built, operated, and guarded by private contractors (Schreier and Caparini 2005).

After the initial combat operation in Iraq, reliance by the US and Britain on PMCs increased even further. PMCs such as KBR, formerly a division of Halliburton, were contracted to provide critical logistical support. The Northbridge Services Group, a British PMC staffed by former CIA, SIS and Special Forces personnel, provided intelligence and counterintelligence
services. CACI International and Titan Corporation provided civilian interrogators and interpreters to the US-run Abu Ghraib prison, where contractors worked closely with military police and intelligence detachments. The British Department for International Development (DFID) employed Control Risks (UK) to provide strategic intelligence advice. MPRI trained US soldiers to run convoys on supply routes vulnerable to ambushes, roadside bombs, and land mines. Vinnell took responsibility for training up to 35 battalions of 1,000 troops each, having experience in just such an activity in Saudi Arabia during the late 1970s. DynCorp recruited, trained, equipped, and sustained a 700-member US contingent responsible for training and equipping a 135,000-member Iraqi police force. The British Foreign Office and DFID awarded ArmorGroup (UK) control of the Iraqi police mentoring program in Basra.

Finally, and perhaps most visibly, the security challenge of the post-war insurgency in Iraq created unprecedented demand for PMCs to protect civilian officials and reconstruction workers as well as nonmilitary buildings, infrastructure and convoys. The Office of Reconstruction and Humanitarian Assistance (ORHA) and its successor, the Coalition Provisional Authority (CPA), contracted British PMC Control Risks Group for risk assessments and security support. The complexity of interdependencies between PMCs also began to escalate, with US Custer Battles and British Olive Security contracted to provide security for reconstruction firms including Bechtel, General Electric, and Fluor (Isenberg 2004; Schreier and Caparini 2005). US-based Blackwater guarded L. Paul Bremer, the head of the CIA, and John Negroponte, the US Ambassador to Iraq. Johannesburg-based Erinys International was contracted to defend oil sites and pipelines, including recruiting, training, and hiring roughly 14,000 Iraqi guards. British Aegis Defence Services, founded by Tim Spicer, was contracted by the CPA to provide security
on all major Iraqi government projects following the handover of sovereignty.

Thus, by start of the Iraq war, PMCs had become engrained in the achievement of the military objectives of sovereign nations. Mutual interdependency had escalated dramatically, with such deep expertise embedded in various corporations that institutions such as the US’s Department of Defence relied upon them for command-and-control operations as well as critical security and policing functions. Military strategy itself had become shaped, in part, by the capabilities available through PMCs, and by the relationships that had emerged between PMCs and US and UK military command. The hybrid operations of PMCs had emerged fully as the US Department of Defence and British Ministry of Defence in particular sought to fill gaps in their expertise, and free their limited sovereign forces to focus on core combat activities.

**IMPLICATIONS**

Our analysis raises several questions for the transaction-cost literature and points to the opportunities for enriching theory in the field of strategic management by integrating insights from the transaction-cost literature with those from the agency and capabilities literatures. First, PMCs as hybrid organizations do not only minimize transactions costs. They also maximize the possible outcomes of transactions. For example, by deploying the capabilities of PMCs in particular settings, military objectives that had not been conceivable become possible. Thus, the particular goals of PMC transactions are endogenous.

Second, the markets in which PMCs interact with sovereign governments and other actors are themselves emerged endogenously and dynamically as institutions after World War II. In part, these markets emerged as new kinds of transactions became possible because of particular PMC capabilities, and in part, the markets developed in response to shifting military
goals.

Third, PMC capabilities are specific assets in the sense promulgated by transaction-cost theory (Williamson 1975), and have become the fulcrum of the interdependency between PMCs and the sovereign nations that purchase their services. Thus, the bilateral dependencies between PMCs and sovereign governments that have emerged over time that define the hybrid status of PMCs also have emerged endogenously. The relational capital that has accumulated between sovereign nations and PMCs both rests on and has become a facet of these specific assets, which are an artefact of the specific historical circumstances that sparked the growth of PMCs over the past 40 years. In particular, whether and how PMCs interacted with hierarchy and markets was endogenously determined by the specific assets that developed over time in the military, in markets, and in PMCs as a result of shifting historical circumstances after the end of the Cold War. Today, the reputational capital associated with PMCs is itself an instrument of war: Merely contracting with EO or Blackwater, for example, provoked a response in the enemy.

Fourth, the co-evolution of specific PMC capabilities, markets, and transaction goals demonstrates that the goals, constraints and parties to a transaction are all endogenously determined by historical and dynamic circumstances. The theory of our case is that the overall architecture of assets, capabilities, resources and skills drives simultaneously the structure of governance and the performance of institutions. The PMC governance system, including its incentive systems, administrative structures, adaptive capabilities and capacity for coordination (Williamson 1991) were not ‘designed’ in these organizations to achieve a desired balance of adaptation and coordination at the lowest possible transaction cost. The history of PMCs after
World War II indicates that governance choices were not optimized based solely on the specific requirements for performance in a single situation given the established levels of asset specificity at a particular point in time. Instead, the governance of military activities emerged through a constrained development process, shaped both by institutionalized administrative structures and by environmental conditions such as the legitimacy of outsourcing, emergence of globalized multinational corporations, and resistance to conscription. PMCs were forward-looking as well as constrained by history in the way that they managed relational capital.

Fifth, the transaction-cost literature emphasizes that varying approaches to contract enforcement apply to markets, hierarchies and hybrids. Williamson (1999) specifically associates litigation with markets, forbearance with hierarchies, and arbitration with hybrids. In the case of PMCs, these distinctions break down as no sovereign authority may be available to enforce contracts. Instead, our analysis demonstrates that contracts involving hybrids are enforced by reputational concerns that carry weight because hybrid organizations seek to interact with sovereign authorities and other parties is multiple contexts and over time. Thus, the integrity of individual transactions involving PMCs depends on the prospect of future transactions involving the principals engaged by PMCs, regardless of whether these principals are employed by the contracting firm.

Finally, our analysis raises questions about how to identify and define hybrid institutions. Applying the criteria of standing transaction-cost theory, PMCs are hybrids, and yet the endogeneity of many elements of the transaction system demonstrates that the mechanisms of governance across markets, hybrids and hierarchies are mutually determined – as was the legitimacy of the institutions themselves. Hybrids are not institutional compromises
between markets and hierarchies that minimize transaction costs; they outperform both markets and hierarchies in adaptation, coordination, incentive and administrative characteristics. Their performance depends both on environmental characteristics and on the path by which capabilities develop within hierarchies, hybrids and markets. The effective regulation of PMCs as a major global industry depends on an enriched understanding of the institutional and environmental context through which PMCs have achieved legitimacy and built capabilities. Our analysis thus points to the need for a dynamic theory of transaction costs – in parallel to and integrated with a dynamic theory of capabilities (Eisenhardt and Martin 2000, Helfat 1997, Teece Pisano and Shuen 1997, Winter 2003) – to understand how markets, hierarchies and hybrids emerge as mechanisms governing exchange.

CONCLUSION

The core of our contribution is an argument that PMCs have evolved as hybrid organizations through several distinct phases since the end of the Cold War in 1989. As the assets specific to military activity were thrown off by the downsizing of sovereign military organizations, small PMCs formed to acquire them and to redeploy them for profit. With time, PMCs evolved as hybrids to develop specialized capabilities deployed in tandem with the specific assets co-created with sovereign military organizations. Thus, PMCs as hybrids now constitute a distinctive industry. This evolution has led to an increasing formalization of PMCs, and ultimately has institutionalized the markets for PMC services. We chronicle the development of PMC governance since the Cold War to show that, as Eisenhower foreshadowed, PMCs have accumulated expert capabilities that can be uniquely deployed to pursue objectives under high-powered incentives that are not available through sovereign
military organizations. The trust, relational capital (Baker, Gibbons and Murphy 2002), leadership and formal governance (Menard 2004) that has accumulated over time between PMCs and sovereign military authorities, together with the battlefield capabilities uniquely available through PMCs, has made them central to military operations in the United States and the United Kingdom. An implication for further research is that hybrid organizations may constitute the bridge between old and new industry structures.

Were Eisenhower’s concerns justified? Do PMCs act as a “technological and scientific elite” that controls public policy? Our analysis suggests that public policy has become, at least in part, shaped by the operation of private institutions, including PMCs and the markets for subcontracted services, where incentive incompatibilities and probity hazards are legion. Yet control is not in the hands of an elite group of purposeful technologists and scientists who seek to craft public policy for private benefit. Science and technology is not at the forefront. No single person or group of people is in charge. Instead, it is the operation of markets themselves – the confluence of excess supply and excess demand thrown off by the end of the Cold War – that has led to the extensive privatization of military services, including command-and-control operations. PMCs have come to define the possibilities available to the US and UK governments as they contemplate combat operations in Iraq and Afghanistan. Avant (2005, p. 6) explains that “in effect, the shift to private guardians changes who guards the guardians.” With the market guarding the guardians, public policy is not controlled by an elite, but, rather, by the interplay of supply and demand.

How did this situation arise? The analysis indicates that PMCs emerged in several phases since World War II: the Cold War period, the post-Cold War period from Berlin to
Mogadishu, filling the security vacuum, implementing foreign policy, and the post-9/11 era.

During the Cold War, outsourcing was limited principally to well-specified, technically driven services. Incentive and administrative systems reflected the potential for large-scale interstate conflict, and were conceived and constructed under the rigidly hierarchical norms of the legacy institutions that had dominated during World War II. Coordination between subcontractors and sovereign military agencies such as the US Department of Defence and the British SAS was essential, with adaptive performance as subordinate.

After the fall of the Berlin Wall and the dissolution of the Soviet Union, legions of soldiers, equipment and technical capacity were released onto open markets, dramatically lowering in the cost of doing business as a PMC. Many firms drew up lists of “consultants,” laid-off soldiers and officers who were available for duty on short-term assignments. The widespread availability of inexpensive, state-of-the-art small arms and equipment meant that PMCs could gear up for small-scale combat operations on short notice. In this environment, founder-owners with low overhead and thin bureaucracy had high-powered incentives and to adapt quickly and effectively to the requirements. Coordination as a principal objective gave way, at least in part, to adaptation, and the consequence was a flood of PMC supply.

Kosovo and Mogadishu represented a critical turning point in which Western nations, and particularly the United States and Great Britain, no longer sought to participate through the direct involvement of military force in remote conflicts that were unpopular domestically. Thus, the demand for PMCs grew in regions that were remote and where operations were not easily observed. The willingness and ability of PMCs to employ professional soldiers and to be measured on outcomes led to a dramatic rise in the number of contracts drawn between PMCs
and African governments, displaced governments, multinational corporations, and other actors. Small-scale intrastate conflicts became the breeding ground for PMC expertise in particular functional and geographic areas. As Western governments sought to enact foreign policy in conflict zones, they turned to experienced and professional PMCs as subcontractors in duties that had traditionally been the province of sovereign military forces.

In the aftermath of 9/11, the US and Great Britain turned to PMCs for functional expertise on a large scale. In the wake of legal tests of their legitimacy, PMCs had become regularized as an integral part of military operations for these sovereign nations. The achievement of both coordination and adaptation without compromise depended on the deployment of PMCs, particularly on missions that might prove controversial, difficult or dangerous to conventional military forces. The administrative systems of PMCs and these sovereign nations had become so deeply intertwined that PMCs were responsible for command-and-control over some key operations, and provided inherently critical support services for command-and-control in other operations. The relational and reputational capital of PMCs had become a centerpiece of their roles in modern conflict. While the incentive compensation systems of PMCs were the subject of controversy, envy and disgust among regular military operatives, their legitimacy had become accepted as required to induce the risk-taking associated with PMC assignments.

This brief history of PMCs demonstrates that the overall architecture of assets, capabilities, resources, skills, etc., simultaneously drove the incentive systems, administrative controls, and performance of these hybrid institutions. Whether and how PMCs interact with hierarchy and markets is endogenously determined by the durable assets – mainly reputational
capital, functional expertise and specialized skills – that developed over time in the military, in markets, and in PMCs. Thus, incentive systems and administrative controls were not designed *per se* in these organizations to achieve the desired balance of performance through adaptation and coordination, but rather the entire system of PMC governance emerged through a constrained process that developed over time.

Our analysis points to the need in the field for a dynamic theory of transaction governance, and points to the role of hybrids as a bridge between established institutions and newly institutionalized industry structures. Understanding how markets, hierarchies and hybrids emerge as mechanisms for governing exchange depends not exclusively or even principally on the design of incentive systems and administrative control systems in the interests of transaction performance. Rather, elements of governance are shaped by prior governance systems inherited from regimes with different performance goals, cultural imperatives, social structures and institutions. Relational and reputational capital are particularly important specific assets in hybrid organizations that shape the very nature of transactions as well as influence the costs of transacting through hybrids. Thus, transaction-governance systems are embedded in a larger scheme of organizational, institutional and environmental factors such as the urgency of the US after 9/11 in pursuing its military goals in Iraq, the general legitimacy of outsourcing, and the accumulated reputational capital of PMCs in particular functional areas. The effective regulation of PMCs as a major global industry depends on an enriched understanding of the organizational, institutional and environmental context through which PMCs have achieved legitimacy.
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Table 1: PMC Operations by Type and Region, 1967-2006*

<table>
<thead>
<tr>
<th></th>
<th>Africa</th>
<th>Asia</th>
<th>Americas</th>
<th>Europe</th>
<th>Middle East</th>
<th>Iraq</th>
<th>Russia</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Operations</td>
<td>598</td>
<td>36</td>
<td>65</td>
<td>79</td>
<td>76</td>
<td>182</td>
<td>11</td>
<td>854</td>
</tr>
<tr>
<td>Provider Operations (%)</td>
<td>125 (21%)</td>
<td>4 (11%)</td>
<td>7 (11%)</td>
<td>7 (9%)</td>
<td>0 (0%)</td>
<td>0 (0%)</td>
<td>0 (0%)</td>
<td>143 (17%)</td>
</tr>
<tr>
<td>Consulting Operations (%)</td>
<td>153 (26%)</td>
<td>14 (39%)</td>
<td>24 (37%)</td>
<td>22 (28%)</td>
<td>28 (37%)</td>
<td>41 (23%)</td>
<td>2 (18%)</td>
<td>241 (28%)</td>
</tr>
<tr>
<td>Support Operations (%)</td>
<td>320 (54%)</td>
<td>18 (50%)</td>
<td>34 (52%)</td>
<td>50 (63%)</td>
<td>48 (63%)</td>
<td>141 (77%)</td>
<td>9 (82%)</td>
<td>470 (55%)</td>
</tr>
<tr>
<td>Total Conflicts</td>
<td>465</td>
<td>597</td>
<td>142</td>
<td>76</td>
<td>210</td>
<td>1</td>
<td>na</td>
<td>1490</td>
</tr>
<tr>
<td>Provider Operations per Conflict</td>
<td>.27</td>
<td>.01</td>
<td>.05</td>
<td>.09</td>
<td>.00</td>
<td>.00</td>
<td>na</td>
<td>.10</td>
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<tr>
<td>Consulting Operations per Conflict</td>
<td>.33</td>
<td>.02</td>
<td>.17</td>
<td>.29</td>
<td>.13</td>
<td>.41</td>
<td>na</td>
<td>.16</td>
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<tr>
<td>Support Operations per Conflict</td>
<td>.69</td>
<td>.03</td>
<td>.24</td>
<td>.66</td>
<td>.23</td>
<td>141</td>
<td>na</td>
<td>.32</td>
</tr>
</tbody>
</table>

*Provider operations include: combat (ground, air), combat support (ground, air), military support, arms provision, counterdrug. Consulting operations include: intelligence, security audits, military restructuring, training (military, police, security, other). Support operations include: demining, engineering services, logistics, maintenance, construction, security (presidential, civilian, commercial, diplomatic, humanitarian, military, corporate, port, airport.

*Sources: Private Military Companies: Options for Regulation, FCO 2002; Department of Peace and Conflict Research at the University of Uppsala; various, authors’ compilation

Figure 1: Global Conflicts*

*Source: Department of Peace and Conflict Research at the University of Uppsala
Figure 2: Global conflicts with more than 1000 deaths*

*Source: Department of Peace and Conflict Research at the University of Uppsala

Figure 3: Global Conflicts With Less than 1000 Deaths*

*Source: Department of Peace and Conflict Research at the University of Uppsala
Figure 4: Number of PMCs*

Figure 5: Number of PMCs by Region*

*Sources: Dunar, Mitchell and Donald (2007), Various, authors’ compilation
Figure 6: PMC Operations*

Figure 7: PMC Operations by Region*

*Sources: Private Military Companies: Options for Regulation, FCO 2002; various, authors’ compilation