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Risks in Outsourcing



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# Risks in Outsourcing

## Introduction

The purpose of this document is to highlight some of the benefits and problems that clients may face should they wish to procure a service by a private or voluntary provider, and some of the information sources for further reading.

Outsourcing Public Services within Government, Local Authorities, and Public Service organisations is encouraged and can be a valuable strategy in improving the delivery of services and projects. However, according to Simon Wren-Lewis, London School of Economics British Policy and Politics, January 2018<sup>1</sup>, the one main benefit of contracting out services is to save money. In light of the past 10 years or so of austerity, perhaps it is not unsurprising that outsourcing is popular and, for many organisations, necessary.

## The Scale

The House of Commons Public Affairs and Constitutional Committee (HoC) published a report<sup>2</sup> on outsourcing, as a result of the Carillion collapse. According to the HoC Report, the UK spends 13.7% of GDP on public procurement, which is not significantly different from countries such as Denmark (14.16%) or Germany (15.05%). The HoC Report also suggests that *“despite the UK leading innovation in this field for some 30–40 years, there has been a depressing inability of central government to learn from repeated mistakes and to some extent the collapse of Carillion and the state of the sector reflect this”*.

## Outsourcing to who?

The definition of outsourcing can be obtained from common dictionaries and in essence can be defined as *‘the process of paying to have part of a company’s work done by another company’*. Some of the major players involved in this bidding are listed below.

### Carillion

Liquidated in January 2018 due to various factors including project overruns or delays in construction projects. At the collapse, it had 43,000 employees globally (over 18,000 in the UK).

### Mitie

A Facilities management company providing services in environmental, catering, cleaning etc. Investigations were carried out by the Financial Conduct Authority in 2017 into the auditing of the accounts by Deloitte following a profits warning in 2016, but were dropped by the FCA in 2018. The company issued a third profit warning in January 2017<sup>3</sup> and acquired Interserve FM in December 2020.

### Capita

Providing adult social and children care services, community services, education, and housing etc., the company shares hit a 15 year low in January 2018 amid profit warnings<sup>4</sup>.

### Serco

Providing services on waste and recycling, leisure, etc. June 2018 saw a fall in share price as the group warned that it expected revenue to fall amid challenging market conditions, however, profits almost doubled in the first six months of the year, with the outsourcer heralding the earnings growth as a sign its five-year strategy was yielding results despite “less than ideal” market conditions<sup>5</sup>.

### Interserve

A Global company employing around 25,000 staff in the UK. It is largely a construction company with interests in PFI schemes for schools and other public services including cleaning. According to the Financial Times<sup>6</sup>, in January 2018 the company was put under a government watch following a profits warning. Further concerns about its finances were raised in November 2018 despite the company stating that the group’s strategy and fit for growth transformation was on track.

## The benefits of outsourcing

As stated previously, the main reason for outsourcing is to save money and according to evidence within the HoC Report, purchasing services from the private sector can reduce costs for the taxpayer by as much as 10-30%.

Also, by outsourcing, there is scope for innovation on how services are delivered. According to the HoC Report, the Global Sourcing Association indicated that purchasing services allows the government to access “talent on a global basis”. With Serco stating it enables bringing new talent with “new ideas”.

Mitie commented that bringing in private sector expertise enables the Government to take advantage of the “innovation and leading-edge technology” which companies bring with them.

## The risks

### Failure to save forecasted costs

Depending on which source you use, for each comment to indicate it is cheaper, there is an equally conflicting view.

The HoC Report identifies ‘Local Authorities have recently argued that providing services themselves is both cheaper and produces better quality services’, but with no reference to the source.

According to a 2018 report<sup>7</sup> by the National Audit Office (NAO Report), legacy Private Finance Initiative deals are forecasted to total £199 billion by the 2040's.

### Loss of experienced personnel

Employees may need to be transferred to the new service provider under TUPE<sup>8</sup>. That in itself should not be an issue provided the Regulations are followed, however, problems may arise if the outsourcing organisation then wished to bring services back in-house. TUPE will apply also but it is unlikely you will get the same numbers of staff with the experience and skills that you TUPE'd out to the contractor, and of those staff that are still available, there may be relationship issues to overcome.

### Failure in continuity of service and reputation damage

As with Carillion, even the largest organisations can go bust. If this is the case, the outsourcing organisation may be left with a financial and service delivery problem to solve quickly, particularly if there is a statutory requirement upon the organisation. Any failure to deliver a service will result in potential reputational damage.

### Lack of control

Loss of control is a condition that may lead to one of the failures above. Outsourcing a service may result in you having little influence over how that service is run.

Standards may drop due to cost savings by the contractor, communications and relationships are strained and as a result, performance management dips. This can result in higher costs with a lesser service standard being delivered.

A report produced by the Institute for Government, 2020, suggested that where services have been insourced, it is mostly driven by pragmatism, rather than ideology. Potential benefits include reduced costs, improved quality, better-integrated services, or increased flexibility over how services are run<sup>9</sup>.

In some cases, government bodies have decided that outsourcing has not worked or has ceased to work. For instance, service quality or reliability has declined, the relationship with a contractor has broken down, or costs have become unsustainable. Some local authorities also cite improving pay and conditions and investing more money locally as reasons to insource.

## If you're looking to outsource

### Key policies

The Cabinet Office have published updated guidance on outsourcing which sets out 11 key policies to consider<sup>10</sup>. The guidance offers clear to improve decision making.

### Be clear about why (the driver) you are outsourcing and even clearer about what (the scope).

- Identify the risks to your objectives/outcomes.
- The internal team should sit down at the outset and map out exactly what it is they are seeking to achieve
- Are you doing this to improve a service or is it to save money?

- What are the projected savings and how long until they are realised?
- Are there any milestones you want to reach during the contract? This will help set out your outcomes and objectives.

### Take time to develop and formalise the contract

- Identify the risks.
- Complexity may lead to confusion. There have been significant failures due to the complexity of contract where neither party actually knew what they wanted as the contract was too cumbersome and therefore not understood properly.
- If necessary, appoint an outsourcing and / or shared services specialist to guide you through the process.

### Ensure compliance and clarity during the contract award stage

- Identify the risks.
- There must be compliance with procurement laws otherwise you may face an expensive civil law suit.
- The HoC Report blamed the UK government for outsourcing contracts based on lowest price.
- Communicate with the in-house team and outsourced-service provider and ensure they are fully briefed on expectations of the contract and the penalties which may occur if they fail to deliver.
- Set and maintain frequency of meetings, recording all outcomes from these for future reference or action.
- Ensure clear lines of responsibility and liabilities are discussed and evidence of this discussion is retained by both parties as part of the contract.

### Once the contract is awarded manage the contract appropriately

- Identify the risks.
- Ensure communication between the in-house team and contractor remains active.
- Develop the relationship between the in-house team and contractor to ensure any problems are fixed quickly.
- Maintain professional clear lines of authority.
- Manage performance in accordance with the contract specification. Address performance failures quickly to ensure they do not contribute to a relationship breakdown.

### If performance is not as expected ensure you have an Exit Strategy

- Identify the risks.
- Ensure you have a robust exit strategy written into the contract in the event that the contractor fails to deliver expected quality etc.
- This includes the rights to data, documentation etc. developed and maintained by the contractor. How do you get access to this?
- If it all goes wrong who owns what?

## Conclusions

It is likely outsourcing services is here to stay and there is potential for more efficient and effective delivery of services and financial savings if planned and managed properly. A few of the major players have been subject to this guide, however, there are many more that can evidence benefit to the service user, host organisation and service provider.

Care must be taken by the procuring organisation in ensuring that outsourcing contracts are properly planned, awarded lawfully, and managed appropriately, and contract specifications are robust and able to withstand threats throughout the contract duration.

## References

- 1 What Carillion's collapse tells us about public sector outsourcing, London School of Economics British Policy and Politics, January 2018  
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<https://publications.parliament.uk/pa/cm201719/cmselect/cmpublicadm/748/748.pdf>
- 3 <https://www.telegraph.co.uk/business/2017/01/18/mitie-issues-third-profit-warning-four-months-new-chief-executive/>
- 4 <https://www.theguardian.com/business/live/2018/jan/31/capita-profit-warning-shares-tumble-markets-nervous-eurozone-inflation-federal-reserve-business-live>
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- 6 <https://www.ft.com/content/1aa17614-fab7-11e7-a492-2c9be7f3120a>
- 7 PF1 and PF2 National Audit Office Report, 18 January 2018  
<https://www.nao.org.uk/report/pfi-and-pf2/>
- 8 Transfer of Undertaking (Protection of Employment) Regulations 2006  
<http://www.legislation.gov.uk/ukSI/2006/246/contents/made>
- 9 Government outsourcing: When and how to bring public services back into government hands, Institute for Government, 2020  
<https://www.instituteforgovernment.org.uk/sites/default/files/publications/government-outsourcing-public-services-government-hands.pdf>
- 10 The Sourcing and Consultancy Playbooks: Key policies and guidance for making sourcing decisions for the delivery of public services, including specific guidance sourcing consultancy services, Cabinet Office, May 2021  
<https://www.gov.uk/government/publications/the-sourcing-and-consultancy-playbooks>

## Further information

For access to further RMP Resources you may find helpful in reducing your organisation's cost of risk, please access the RMP Resources or RMP Articles pages on our website. To join the debate follow us on our LinkedIn page.

## Get in touch

For more information, please contact your broker, RMP risk control consultant or account director.

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