Risk control
Risks in Outsourcing

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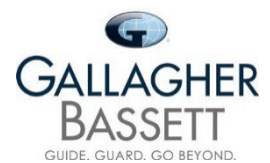
Risks in Outsourcing

Introduction

The purpose of this document is to highlight some of the benefits and challenges that organisations may face should they wish to procure a service via a third-party provider.

Outsourcing can be a valuable strategy in improving the quality in delivery of services and projects. Another primary motivation for outsourcing services is the potential for cost savings. Considering the continuing financial pressures experienced by organisations, it is not surprising that outsourcing remains a popular and sometimes necessary option for many organisations.

Learning from Mistakes

As a result of the failure of Carillion Plc in 2018, which held approximately 450 government contracts at the time it entered administration[1], The House of Commons Public Affairs and Constitutional Committee (HoC) published a report on outsourcing[2]. The report suggested 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 Defined

In most instances, an organisation would be outsourcing when it participates in an arrangement, usually contractual, where a third-party service provider performs a process, service, or function on behalf of the organisation which it would otherwise have conducted itself. So, for example, a Highway Authority may outsource the functions of highway inspection and / or highway maintenance to a third-party provider.

Some of the largest outsourcing providers in the UK include:

Mitie

One of the UK's leading Facilities Management and Professional Services companies[3] providing a wide range of services across many areas including: decarbonisation and energy; facilities and estates; projects and workplace; and security and intelligence.

Capita

Capita is a leading provider of business process services within the UK[4]. It offers services across a wide range of industries including central government; local government; defence; education and learning; financial services; and health.

Serco

Serco specialise in the delivery of essential public services, defence, transport, justice, immigration, healthcare, and other citizen services across four regions: UK & Europe, North America, Asia Pacific and Middle East[5].

The Benefits of Outsourcing

As already recognised in this document, a primary motivation for organisations to outsource is to save money. The HoC Report previously referenced suggested that purchasing services from the private sector can reduce costs for the taxpayer by as much as 30%.

Outsourcing can also provide opportunity for innovation within service delivery, whilst also potentially enhancing access to wider talent pools.

The Risks

Loss of Experienced Personnel

Employees may need to be transferred to the new service provider under TUPE[6]. That should not be an issue provided the regulations are followed, however, problems may arise if the outsourcing organisation then wishes to bring services back in-house at some future time. TUPE will also apply in these circumstances, but there is a chance that not all the experienced and skilled staff who were originally transferred to the contractor will return. Some resentment may exist within staff groups due to the uncertainty created through the transference between different employers.

Failure of Service Continuity

As the Carillion Plc case taught us, even the largest organisations can fail. In such circumstances the outsourcing organisation may be left with financial and service delivery challenges that may require a quick resolution. This is particularly true if there are statutory requirements placed upon the organisation to deliver the effected service, or where service disruption may have significant consequences for the service users.

Lack of Direct Control

Outsourcing of a service may result in a reduction and influence over how that service is run on a day-to-day basis for the outsourcing organisation.

Outsource providers are usually, but not always, commercial entities seeking to make a profit. It is not completely beyond the realms of possibility that cost cutting activities are considered if profitability is at risk. In such circumstances relationships can become strained as a result as the issue of quality and performance of the contract comes into focus.

A report produced by the Institute for Government[7] suggested that where services are brought back in-house after a period of outsourcing, pragmatism rather than ideology is often the motivation. Potential benefits associated with bringing services back in-house can include reduced costs, improved quality, better-integrated services, or increased control over how services are run. Many of these reasons may have been considered as part of the rationale for outsourcing the service in the first instance.

Outsourcing Considerations

HM Government has published guidance on sourcing[8]. The document offers clear advice to improve decision making.

Be clear about the objectives for outsourcing and even clearer about the scope.

— Identify the risks to the objectives / outcomes

— The internal team should sit down at the outset and map out exactly what it is they are seeking to achieve

— Is the objective to improve a service, save money, or both?

— What are the projected savings and how long until realisation?

— Are there any milestones to reach during the contract lifetime? This will help set and measure outcomes and objectives

The Contract

— Identify contract risks

— Complexity may lead to confusion. There have been significant failures due to the complexity of contracts where neither party understood the contractual requirements as it was too cumbersome and / or complex

— If necessary, appoint an outsourcing lead and / or shared services specialist to provide assistance with the process

Compliance and Clarity

— Identify compliance risks

— There must be compliance with relevant procurement laws otherwise any contract award may be challenged

— Resist the temptation to award contracts based purely on the lowest price

— Communicate with the internal outsourcing 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 and communications, recording all outcomes

— Ensure responsibilities and liabilities are discussed and clarified, with evidence of discussions retained by both parties

Contract Management

— Identify the risks to the performance of the contract

— Ensure communication between the internal team and contractor remains active, including the regular reporting of performance metrics

— Develop the relationship between the internal team and contractor and establish a dispute resolution protocol to ensure any problems are resolved efficiently without becoming adversarial

— Establish 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

Exit Strategy

— Identify the risks to exiting the contract

— Establish contingency arrangements to cover an early exit from the contract

— Ensure a robust exit strategy is written into the contract if the contractor fails to deliver to the specified contractual requirements

— Clearly establish the rights to data, documentation etc. developed and maintained by the contractor and agree protocols for its transfer. Data transfer and management must be in line with relevant legal requirements such as those specified within the Data Protection Act 2018[9]

Conclusion

It is likely that the outsourcing services is here to stay. Outsourcing does offer potential for more efficient and effective delivery of services and financial savings if planned and managed properly. Increasing the potential for innovation whilst accessing wider talent pools are also very compelling reasons when considering such actions.

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

And with history telling us that even the largest of companies can fail, prudent organisations should always consider the question of 'what if?' and ensure that contingency plans are in place to mitigate the effects of outsourced provider failure.

References

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8 HM Government, The Sourcing Playbook: Government guidance on service delivery, including outsourcing, insourcing, mixed economy sourcing and contracting, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/987353/The_Sourcing_Playbook.pdf

9 The Data Protection Act 2018, available at: https://www.gov.uk/data-protection

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.

contact@rmpartners.co.uk

rmp

Risk Management Partners

The Walbrook Building
25 Walbrook
London EC4N 8AW

020 7204 1800
rmpartners.co.uk