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SECTION 1

Introduction

1.1 PURPOSE OF THIS GUIDE

This is a practical guide for public sector organisations who are thinking of outsourcing a particular service, reviewing an existing outsourcing arrangement or rethinking their entire strategy in relation to outsourcing. It sets out the issues they need to consider, including whether outsourcing is indeed the best option, and explains what is required at each stage in order to maximise the chances of a successful outcome.

There is already an abundance of literature on this subject, but much of it originates from those who have a vested interest in either supporting or opposing outsourcing. There is some good, impartial guidance (of which various reports published by the National Audit Office are notable examples) but this tends to focus on issues with particular contracts or to set out general principles of good practice. Until now, there has been no practical step-by-step guide available from an impartial source; this is the gap that this publication seeks to fill.

The factual material and references to public sector organisations in this guide are specific to England unless stated otherwise. The main principles are, however, applicable to public sector organisations everywhere.

1.2 EXECUTIVE SUMMARY

Since the introduction of compulsory competitive tendering in the 1980s, outsourcing has been extended to more and more areas of public service provision in the UK. In the wake of the 2008 financial crisis, the pressure to outsource has intensified, with Prime Minister David Cameron declaring in July 2011 that henceforward the state would have to justify why it made sense to ‘run a monopoly’.

The outsourcing market in the UK today is huge. A review based on data from 2010 indicated that it was worth £72bn per annum, accounted for around 3% of GDP and employed around 4% of the workforce. It is likely that there has been a significant increase since then as the government has extended outsourcing into new areas. International comparisons show that the UK has one of the highest proportions of outsourced public services in the world.

While the advance of public sector outsourcing seems to be inexorable, there is no conclusive evidence to support the view that this trend is generally beneficial. Indeed there are numerous examples of outsourcing arrangements that have failed, in some cases spectacularly. There are also numerous examples of services having been brought back in house when contracts have expired. These examples do not, however, provide conclusive evidence to support the opposite view – that outsourcing is a flawed concept in principle; they merely show that success is not guaranteed.
This guide has two key messages for practitioners: the first, that they should think carefully before taking a decision to proceed with outsourcing, and the second, that having decided to outsource, they must plan and manage the project very carefully in order to maximise the chances of success.

Decisions to outsource should follow an appraisal of the pros and cons of different delivery models, including in-house solutions. Such decisions are, however, best taken within the framework of a corporate sourcing strategy, which includes plans for how and when the delivery models for various services will be reviewed and how the organisation’s resources will be deployed to ensure different sourcing projects are delivered successfully.

Public sector clients commonly fail to plan, procure and manage their outsourcing projects properly, with the result that projects either fail in an obvious way or, more insidiously, fall short of achieving their full potential benefits. The planning phase is the most critical; investment of time, effort and resources at this stage is the key to success as the project is procured and delivered.

Clients need to think through all the key issues before commencing procurement of an outsourcing project. These issues include:

- what their objectives are for the service being outsourced
- how outsourcing will deliver benefits that cannot be achieved in house
- to what extent the project will be innovative or based on a tried-and-tested approach
- what type of procurement process will be used
- what type of contractual arrangement there will be with the supplier
- to what extent requirements will be expressed in terms of inputs, outputs and outcomes
- what the contractual incentives will be on the supplier to perform
- how the contract and the relationship with the supplier will be managed
- what will happen when the contract ends.

To inform their thinking about these issues clients should:

- learn lessons from other outsourcing projects delivered by their own and other organisations
- consult with key stakeholders, especially end users and employees
- engage with suppliers.

Meaningful engagement with suppliers is critical in order for clients to test the realism of their assumptions about what outsourcing can deliver. Such engagement therefore needs to start before a decision is taken to proceed with outsourcing.

Clients also need to consider how they will maintain employee morale during a period of transition and uncertainty. This is critical in order to maintain productivity during the transitional period, avoid an exodus of disaffected employees and ensure that employees transferring to the new supplier are motivated to perform well.

Where a decision is taken to outsource, there should be a presumption in favour of competition, as restricting competition may preclude the best bids and thereby result in a
worse outcome. Competition should only be restricted where there is a sound reason why this will achieve better value for money than a procurement process open to any interested party.

Clients need to be aware of the internal and public procurement rules that apply to their outsourcing projects. Under the EU rules, which have recently been revised, there is a specified threshold above which contracts for most services must be advertised in the EU’s official journal, OJEU, in which case the contract must be procured in accordance with one of five specified procedures. Contracts for certain services – notably in the areas of social care and health care – benefit from a light-touch regime, under which the prescribed procedures do not have to be used and only contracts that exceed a considerably higher threshold than the usual ones must be advertised in OJEU. There are also new rules that are specific to England, which require certain contracts below the EU thresholds to be advertised on a government website.

As an outsourcing project proceeds to selection of a preferred bidder, with resources focused on the finalisation of the contract, clients often neglect the need for both parties to begin to mobilise for handover. It is essential that sufficient time and effort is devoted to this exercise; otherwise performance is likely to dip at the beginning of the operational phase, which may jeopardise the overall success of the project. Adequate time for mobilisation therefore needs to be built into the project plan and, if the procurement process is completed later than expected, handover may need to be postponed.

Contract management is a much undervalued discipline, with the result that public sector organisations often fail to recognise the levels of resources and skills that are needed on the client side during the operational phase. The client team requires a combination of commercial, financial and administrative skills in order to manage the contract effectively. It also requires good interpersonal and negotiating skills in order to manage the relationship with the supplier.

As an outsourcing contract approaches expiry, sufficient time needs to be allowed for a proper appraisal of options for future delivery and then for implementation of the chosen solution. Planning may need to commence as much as two years prior to expiry to allow time for re-tendering, should that be part of the solution. An unplanned extension of the existing contract should be avoided, not only because this may breach procurement rules, but also because the supplier may be unwilling to continue, or unable to maintain its performance, if given short notice of the client’s wish to extend.

It is easy to get bogged down in the day-to-day issues of managing a contract, but it is important for the parties to carry out periodic reviews of the written contract and the relationship between them. This enables the outsourcing arrangement to be adapted to reflect changing circumstances and to meet current needs. A final review should be carried out shortly after the contract has ended; lessons learned can then be fed into the organisation’s sourcing strategy and used to improve the delivery of future outsourcing projects.

When comparing an outsourcing proposal with other delivery options, clients may find it useful to consider whether the improvements that the supplier might deliver under outsourcing – such as making changes to working practices and streamlining decision-making processes – might be better delivered in house. The latter approach could enable
savings to be implemented more quickly and, by avoiding the procurement and contract management costs that an outsourcing project entails, yield a higher net saving to the client organisation.

There are various models for delivering public services other than in-house management and a straightforward outsourcing contract. These include establishing separate entities to provide services, shared services and assisting other organisations to provide services. The use of these models is becoming increasingly common in the UK and should be considered as part of the corporate sourcing strategy.

1.3 STRUCTURE OF THIS GUIDE

Section 2 describes the seemingly inexorable advance of the public sector outsourcing market in the UK, including the increasing involvement of voluntary and private sector suppliers in the provision of social care and health care. It provides an assessment of the size of the UK market and some international comparisons. It describes some of the successes and failures of outsourcing and explains that these provide useful lessons for practitioners who are trying to decide whether outsourcing is the right solution or who are planning an outsourcing project. It also provides examples of organisations that have recently brought services back in house.

Section 3 explains how a public sector organisation should go about deciding the best ways to deliver its various services: in-house management, outsourcing or alternative delivery models. It recommends a strategic approach to sourcing expressed in a corporate sourcing strategy. It describes the pros and cons of outsourcing and other delivery models. Finally it explains how market testing may be used to assess the efficiency of an in-house provider.

Section 4 describes what needs to be done to prepare for an outsourcing project. It argues that considerable upfront work is required to determine whether outsourcing is the right solution and, if a decision is taken to go ahead with outsourcing, to ensure that the project is managed properly. It explains the importance of learning lessons from other projects and consulting with end users, employees and other stakeholders. It also argues that engaging with suppliers before procurement commences is essential in order to ensure that the project is based on a sound understanding of commercial realities and what the market can deliver. Finally it describes how resources should be planned and marshalled in order to deliver a project successfully.

Section 5 sets out the key issues that clients need to consider before they commence procurement, including what their objectives are for the service being outsourced, how they will procure a supplier, the type of contractual arrangement that will be used, what the length of the contract will be, how service requirements will be expressed in the contract, what type of KPIs and other incentives to perform will be included in the contract, how the contract and the relationship with the supplier will be managed and what will happen when the contract ends.

Sections 6 to 9 explain what public sector clients need to do at each stage of an outsourcing project to maximise the chances of success.
Section 6 focuses on the procurement phase. It argues that there should be a presumption in favour of competition when services are being outsourced. It provides a summary of the revised procurement rules that came into effect on 26 February 2015, including the EU rules and additional rules that are specific to England. It explains what clients need to do in order to prepare for and manage the procurement process.

Section 7 sets out the specific issues that clients need to address during the mobilisation stage – when both the client and the supplier are preparing for the handover of the services. It stresses the importance of ensuring that sufficient time is allowed for mobilisation.

Section 8 describes the key issues for clients during the operational phase. It explains that equal importance needs to be given to managing the contract and managing the relationship with the supplier. It sets out how the in-house team responsible for managing the contract might be organised. It also recommends that there should be periodic reviews during the operational phase. Finally it describes how clients may change their contracts in response to changing circumstances and needs.

Section 9 describes the different options available to clients when an outsourcing contract is approaching expiry or being terminated early, including re-tendering the service and bringing it back in house. It also recommends that there should be a final review, after the contract has ended, to provide lessons learned and improve the organisation’s sourcing strategy.

Section 10 explains that the improvements organisations seek to achieve through outsourcing can sometimes be better achieved by introducing change in house. It suggests a number of in-house solutions, which may be appropriate, depending on the problem that is being addressed.

Section 11 describes a number of alternatives to traditional in-house management and straightforward outsourcing. These include establishing new entities to provide services, collaboration with other public sector organisations and facilitating other organisations to provide services. It argues that these models should be considered as part of the organisation’s corporate sourcing strategy, but that clients need to apply a similar degree of rigour to assessing the costs and benefits of these models that they would to an outsourcing proposal.

The guide ends with a further reading section for those interested in delving deeper on specific topics.