

# Outsourcing

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Summary

CIPS takes the view that the outsourcing of services to specialist providers can often lead to better quality of services and increased value for money. Purchasing and supply management professionals should have the knowledge and skills required to manage the outsourcing process and to advise colleagues of the most appropriate solution to obtain best value for money in the provision of services. CIPS strongly recommends that the purchasing and supply management professional ensures clarity on the rationale for outsourcing at the outset and that until such clarity is achieved the purchasing and supply management professional should advocate caution when embarking on the outsourcing process.

## Definitions

CIPS defines outsourcing as "the process of identifying the most suitable expert third party service provider to undertake the management, administration and provision of the service in question".

Facilities management is a type of outsourced service in that it is the contracting out of all activities connected with the organisation and control of a facility such as catering or security.

Outsourcing should not be confused with privatisation. The latter can be defined as taking the control and ownership of an enterprise, or part of an enterprise, from government or local government and placing this in the hands of private investors such as individual shareholders or other bodies.

## Potential Advantages of an Outsourced Service

CIPS believes that outsourcing services to organisations which are specialists in the provision of the service in question can lead to many benefits including:

- More efficient and expert service e.g. compliance with industry standards
- Improved resources e.g. staff being professionally trained
- Higher quality of service
- Customers' needs being met
- Lower overall cost
- Concentration by buying organisation on core activity

CIPS also recognises that many organisations have not realised the potential from outsourcing. Typical reasons for this include:

- Poor requirement specification
- Failure to attract innovation
- Outsourcing a poorly performing area without attempting to improve it first
- Weak and badly written contracts
- Poorly handled workforce issues
- Conflict of interest between colleagues
- High bidding costs
- Inappropriate allocation of risk and reward

CIPS believes that the benefits delivered from outsourcing depend upon:

- The degree of efficiency in the in-house service
- The extent to which customers' needs were already being met

- The process used to determine the service provider and the outsourced requirement specification
- A well written and properly managed contract e.g. with a service specification which includes descriptions and service levels

## Outsourcing Strategy

CIPS recommends that the purchasing and supply management professional works cross-functionally with colleagues in for example, Finance and Human Resource Management in order to determine:

- the outsourcing strategy and the rationale behind it and;
- to manage the process and the deliverables

CIPS believes that it is imperative when contemplating outsourcing, that the purchasing and supply management professional obtains visible commitment to the outsourcing strategy from senior management and where appropriate the Board of Directors. The outsourcing strategy must also be supported at all management levels within the organisation.

The outsourcing strategy must be underpinned by professionally executed change management principles. This is particularly important in respect of those staff providing the existing in-house service.

When selecting those services for outsourcing, the purchasing and supply management professional with the cross-functional team needs to identify those services which are core to the organisation. CIPS believes it is not good practice to outsource core services.

Outsourcing is usually applied to those services which support the organisation in the delivery of its core business. Having determined which services are non-core to the organisation, the outsourcing team should then identify which of these non-core services are operational (e.g. cleaning, security, catering) and those which are strategic (e.g. information technology or human resource management). Clearly, strategic services require a greater concentration of effort with a proactive, clear and robust strategy for each service being considered for outsourcing.

## Procurement Process

The fundamentals of good procurement practice apply equally to outsourcing such as, for example adherence to the CIPS personal ethical code and, in the public sector, the need for purchasers to comply with the EC Procurement rules. This policy document is not intended to provide detailed guidance on outsourcing but rather to summarise CIPS' particular views on the issues pertinent to the procurement process of outsourcing. Further guidance is available from CIPS.

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## Make or Buy

CIPS suggests that the first stage in any outsourcing strategy should be to determine whether the service in question should continue to be run in-house or whether it should be outsourced to an external service provider.

If the in-house service can be improved, perhaps by advice from external consultants or ideas from a benchmarking exercise, coupled with increased training and targets for greater efficiency, the in-house option may remain attractive. The benefits of determining the "make or buy" decision at the outset i.e. not having the in-house team compete with external service providers, has the following benefits:

- It gives staff a clearer picture of what is likely to happen and time to prepare
- It allows purchasers to get the best from the procurement route that they have chosen
- It offers suppliers confidence that the competition is being conducted in good faith
- It avoids conflict of interest in the buying organisation e.g. loyalty to existing colleagues
- It enables the in-house team to concentrate on delivering the service rather than preparing a bid
- It avoids the danger of producing a biased specification of requirements

It avoids the need to provide finance, or other forms of assistance e.g. marketing and presentational skills, to the in-house team so that they can compete effectively

Should the buying organisation decide to take the "Make or Buy" decision at the end of a tendering process, having included an in-house bid, care must be taken in evaluating the in-house bid. It can be very difficult to determine the true cost of an in-house service and whoever is responsible for evaluating it will need to have information on for example:

- human resources and payroll
- facilities management
- IT
- telecoms
- cost of overheads
- bought-in materials

## Staff Issues

CIPS emphasises the importance of professionally managing staff issues when undertaking outsourcing. Those currently providing the service in-house will naturally feel vulnerable and this can affect morale and staff motivation. Some staff may even feel inclined to look for alternative employment which may result in a loss of key skills.

For this reason, the purchasing and supply management professional must develop a staff communications plan with the head of the organisation's human resources, to fit within the outsourcing strategy. This should aim to ensure that the service is not affected during the transitional period. The time-scales involved in outsourcing can often be quite long and so staff must be kept informed, reassured and have the opportunity to air their concerns.

## Transfer Of Undertakings And Protection Of Employment (Tupe) Regulations

This is one of the key issues to be addressed when considering outsourcing. CIPS recommends that the purchasing and supply management professional employs a legal adviser in respect of TUPE as the law is subject to change and may be difficult to interpret correctly.

CIPS recognises that TUPE is important in terms of handling of workforce issues. It aims to ensure that existing staff, currently providing the service in-house, will be transferred to the new service provider under the same terms and conditions of employment. It should then become the service provider's responsibility to manage, train and support those staff to enable them to deliver the new service. However, some service providers have been known to wait only for the minimum period in law to expire before they begin re-organising staff which leads to changes in terms and conditions.

CIPS recommends the purchasing and supply management professional working with the cross-functional team sets down the ground rules for outsourcing services and for running subsequent generation competitions. They should stipulate that staff should transfer and that at the end of the contract period, TUPE will apply again. Potential service providers require accurate and timely information about the workforce that will be transferring such as certainty about terms and conditions of staff. Without such information, bidders will have to build into their bids potential redundancy costs which will diminish value for money.

## Tendering

The outsourcing of services can be undertaken by means of a competitive tendering process (reference should be made to the CIPS policies and positions on negotiation, tendering, and post tender negotiation).

There are also cases where relationships develop so that the tender process is not appropriate. In some instances, the tender process may even cause deterioration in the relationship with the most likely contender. It should be a responsibility of the purchasing and supply management professional to determine whether or not a tendering process is appropriate for each outsourcing procurement activity.

For some services, it may be necessary to create markets as for example, local authorities are doing under the Best Value legislation. This might involve developing suppliers to deliver a new service for instance (reference should be made to the CIPS policy on Best Value).

If the purchasing and supply management professional determines that tendering is the most appropriate route to an outsourced service then, as with any complex procurement, the entire process must be carefully thought through, with time-scales identified.

One issue to be considered is the number of service providers invited to tender as they incur high costs in tendering which are, ultimately, passed on to the customer. Clearly, however, the purchasing and supply management professional needs to ensure that there is sufficient competition and that those invited to tender have a realistic chance of winning the business.

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An effective way of ensuring competition is to have a pre-qualified list of service providers. The service providers on the list should satisfy the first level of the selection criteria e.g. with respect to their financial standing, track record, capacity to deliver etc. (Pre-qualification is addressed in the CIPS policy on tendering, negotiation and post tender negotiation.)

## Outcome/Output Based Specification

One of the key issues in outsourcing is generating innovation (reference should be made to the CIPS policy on innovation). Purchasing and supply management professionals should endeavour to encourage innovation from the service providers in the contracting process starting with the employment of an output or outcome-based specification. This should be comprehensive and cover everything that is required but it should not stipulate how this should be achieved.

The purchasing and supply management professional, working with the cross-functional team, should diagnose the strengths and weaknesses of the service currently being provided and work with customers to ascertain their needs and aspirations in respect of the service. CIPS emphasises the importance of involving internal customers of the service throughout the procurement process in order that they feel they have been properly represented and have ownership of the solution. The findings from this diagnosis will form the core of the outcomes expected but it should be the responsibility of the service providers to submit, in their tender, their own individual solution (or a range of solutions) to the service as appropriate.

Whatever method is employed to develop an innovative value for money solution this must be transformed into the specification of requirement or the service description before the contract is awarded. This is necessary so that both parties have a documented, clear and thorough understanding of what is expected to be delivered, from both parties. This of course can be subject to improvement, post contract award, as deemed appropriate.

One method of generating an innovative solution is to issue the outcome-based specification at the pre-qualification stage and have suppliers submit ideas in response to that which can then be used to develop the specification further. However, the purchasing and supply management professional should ensure that service providers are aware of the purpose of doing this and that this information will be shared within the marketplace.

## Transfer of Risks, Responsibilities and Benefits

Outsourcing can involve the transfer, as appropriate, of those risks associated with the contract as well as responsibilities. As part of the initial diagnosis of the current situation, the purchasing and supply management professional with the cross-functional team, should endeavour to identify all risks and responsibilities associated with the service.

Risks and responsibilities can be illustrated by means of a table; it is good practice to have the bidders stipulate in their tenders which risks they would be willing to take responsibility for, should they be awarded the contract. These can then be negotiated during the process of bid clarification. However, risks have a high cost associated with them and as price and risk are interdependent, ultimately the buying organisation will pay for passing any risks on to the service provider. CIPS suggests that the aim should be optimum risk

allocation and that the party which is allocated a particular risk should have the freedom to manage it.

Equally, benefits expected to arise from the contract should be ascertained as far as possible prior to inviting tenders. The tenderers should be requested to stipulate those benefits that they would be willing to share and to identify any others which may arise from the contract. Benefits, like risks, should be measurable and quantifiable and once the contract is in place, should be monitored and managed accordingly. These benefits can act as incentives to the service provider and ensure that the buying organisation is perceived by the supplier as a key client.

## References

Before deciding on the successful service provider, indeed as part of the procurement process, it is important that the preferred bidder's, or even the short-listed service providers', references are contacted and, where appropriate, visited. Reference sites are an effective way of ascertaining whether the service provider can in fact deliver the solution required.

## Interpersonal Issues

CIPS strongly recommends that potential service providers are invited to present their solution to the buying organisation as part of the procurement process. "Beauty Parades" are an essential part of the outsourcing process and as such purchasing and supply management professionals must ensure that the people who will be managing the service are present, if not actually presenting, in order that they can meet them.

Equally, when discussions or negotiations are taking place, the key staff expected to manage the contract must be present. It is important that the buying organisation is comfortable with the people with whom they will be working. Further, the purchasing and supply management professional should ensure that there is provision that the buying organisation has a role in the selection of new staff to manage the contract. For example, in the circumstances that the staff allocated to manage the contract choose alternative employment or move to another part of the service provider's organisation.

## "Babies and Bath Water"

When outsourcing strategic services particularly, care must be taken to ensure that the knowledge and competencies required to deliver the service, currently residing within the organisation, are not lost during the contract period. For this reason, CIPS recommends that appropriate exit strategies are built into the contract and these might state the requirement for skills and knowledge transfers, so as to prevent the buying organisation becoming dependent on the contracted service provider.

CIPS suggests that buying organisations should try to retain the intelligent client capability i.e. appoint an internal expert to manage the contract so that they retain and develop the knowledge in question. This person can also provide a valuable contribution to contract variations and amendments by presenting an informed internal view.

The buying organisation needs to be in a position, at the end of the contract period, to competitively tender the contract again. This may include inviting the current service provider to bid. In some cases, it may make commercial sense to simply re-negotiate with the existing contractor, especially if market testing has demonstrated that the service provider has continued to deliver value for money.

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## Contract Documentation

An outsourced arrangement must be supported by an expertly written contract. Unlike the purchase of supplies, the purchase of services is not effectively covered under common law. CIPS recommends that the contract comprises an effective set of terms and conditions, covering issues such as conflict resolution, as well as special clauses to cover the specific service in question.

A draft set of terms and conditions should be included in the invitation to tender and the tenderers invited to submit any special clauses they deem appropriate which can be subjected to bid clarification at a later stage.

Both parties should aim to continually improve both the service, the contracted relationship and the processes that support them. CIPS recommends that purchasing and supply management professionals include mechanisms in the contract to review processes and working practices in the light of experience. The service should develop, and in many cases change, during the contract period and so it is important to include change management clauses in the contract. These might define a protocol for change to ensure that any such change is discussed by both parties and approved in writing before being implemented. The changes might also have implications in respect of incentives, benefits and risk, and so the contract documentation may need to be varied to accommodate change as it arises.

## Contract Period

When outsourcing, the length of the contract needs to be determined at the outset. CIPS believes that an outsourced service contract should have a minimum duration of three years. The contract should provide for exit strategies including appropriately drafted termination clauses if, for example, the service provider repeatedly fails to deliver the required level of service.

Some outsourced contracts can involve a financial input from service providers, possibly under a PFI type arrangement, and as such the service provider will require a greater period to receive a return on its investment. It is not unusual to have contracts with durations of seven or ten years and in some industries e.g. construction, 15 or 25 years is not unusual. The important issue is that the contract provides for exit strategies and that the relationship is properly managed.

## Managing the Contract

Notwithstanding the benefit of an appropriately written contract, with a "service specification" that includes for instance service levels, service descriptions, agreed incentives, benefits and risks, it is imperative that the contract is properly managed. Regular contract management reviews are essential to ensure that both parties are meeting their respective obligations and that the service is being continually improved. These reviews are particularly important in long and complex contracts.

Contract management reviews might involve regular scheduled meetings with the service provider to monitor performance, to develop the service and to measure the extent to which the benefits are being delivered. They can also include subjects such as administration, the technical relationship, as well as contractual matters. In a partnering style relationship, problems can be addressed and resolved quickly especially if a rapport has built up between key personnel from both parties. It is essential that the buying organisation's contract manager is commercially astute in

order to prevent the service provider from seeking opportunities to maximise profit by reducing the quality of service or by seeking opportunities to increase charges.

In order to limit difficulties of an adversarial nature, CIPS would recommend that a partnering style relationship is entered into between the buying organisation and the service provider especially when the service in question is strategic to the buying organisation. (Reference should be made to the CIPS policies on partnering and supplier development). Nevertheless, when conflict does arise, conflict resolution mechanisms should be employed which should already have been addressed at the time the contract was negotiated and signed.

## Outsourcing Purchasing and Supply Management

CIPS believes that purchasing and supply management is a non-core but strategic service except in some small organisations. As such, purchasing and supply management may be a contender for outsourcing and a number of organisations have already outsourced their purchasing and supply management function.

As with any other strategic service, purchasing and supply management must continually improve and be properly managed with objectives and targets that are both quantifiable and measurable. It is often the role of the Internal Audit department to determine whether or not the purchasing and supply management function, often within the context of limited resources, is delivering the best procurement service possible. Where it is not, as with any other service, the service should be evaluated and the expected or required level of service ascertained.

The resources required to meet these expectations should be identified along with any skill gaps within the purchasing and supply management team. CIPS believes that it is the responsibility of purchasing and supply management professionals to deliver year-on-year continuous improvement and to ensure that their own knowledge, skills and competencies are continually developed. The purchasing and supply management professional should test their own stakeholders and customers and ensure that the level of service required is being delivered. Further, they should market their successes by means of an annual report and presentations to senior management and customers.

CIPS suggests that professional services such as purchasing and supply management lend themselves to "selective" outsourcing for example:

- the increased use of consortia contracts for commodity items
- use of third party expertise for one-off irregular procurements
- use of bought-in expertise for specialist markets such as energy

CIPS believes that most organisations will benefit from retaining control of their purchasing and supply management, especially the procurement of core goods and services, but this does not necessarily mean that all purchasing and supply management should be undertaken in-house.

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## Conclusion

The CIPS believes that outsourcing should deliver improvements in value for money if the contracting process is undertaken professionally. Purchasing and supply management professionals should take a proactive role in respect of outsourcing in their organisations, by identifying those services which should be subjected to these processes and outcomes. Outsourcing is another method by which the purchasing and supply management professional can raise the profile of the profession within their own organisation and in the business environment at large.

Competence in outsourcing and its associated activities are fundamental to the purchasing and supply management professional and, as such, they should ensure that these skills are continually developed and refreshed by professional training as appropriate.