

Insourcing

Why customers take contracts back in house – and how to avoid it





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Introduction

Whilst the outsourcing market continues to grow, and the majority of ongoing contracts are rebid, there is always the possibility the customer may decide to take some or all of the work delivered on your contract back in house. Usually this will happen at the end of the contract period after a review of options, but sometimes the customer cuts the contract short.

As the incumbent, either option is bad news. Even if you are compensated for a terminated contract you lose the ongoing revenue for the contract and there may be reputation issues with other customers and stakeholders asking why the customer felt your delivery wasn't delivering enough benefits to keep the contract outsourced. Some solicitations specifically ask whether your company has had a contract terminated recently and you have to go through an explanation of why, or even potentially lose marks in the evaluation.

We've reviewed four papers based on research projects covering Insourcing, published over the past 10 years, to pull out how common Insourcing is; why customers insource; and what benefits they feel they gain from it. This paper summarises those issues and then goes through what you can do as the incumbent to reduce the risk of your customer insourcing your contract.

The Research

The four research projects we have used are:

- **Pragmatism Over Politics: Alternative Service Delivery in Local Government.** Published in 2004 and written by Mildred Warner and Emir Hefetz the paper covers the changing results of the International City/County Management Association (ICMA) survey of US City and County Chief Administrative Officers between 1992 and 2002. The research isn't wholly focused on insourcing, but covers it as part of the wider results from the surveys.
- **Calling a Change on the Outsourcing Market.** Published by Deloitte Consulting in 2005. This research project focuses primarily on some of the world's largest private sector customers (the average participant had annual revenues of \$50bn). It covers the issues and risks they felt they faced with outsourcing, the problems they had faced with outsourcing projects and what the results of insourcing some of these projects had been.
- **Insourcing: A Guide to Bringing local Authority Services Back In-House.** Published by the Association for Public Service Excellence (APSE) in 2009. This paper investigates the reasons why UK Local Authorities bring contracts back in house, the methods they have used and the benefits they have seen. It includes over 50 examples from the period 2000 – 2009 and a number of case studies.
- **Insourcing Update: The value of returning local authority services in-house in an era of budget constraints.** Published by Unison in 2011, the paper updates APSE's 2009 report with further examples of insourcing from the period 2009 – 2011 and an update on the reasons for and results of insourcing using more recent case studies.



We have also pulled on more recent figures from Deloitte's **2012 Global Outsourcing and Insourcing Survey** which, whilst more general in its focus also includes some useful figures for comparison

If you want to read the papers directly we have included links to them at the end of this paper – they are all available publicly and can be found via Google searches of their titles.

Summarising the results

We won't go into detail of what were in some cases large scale surveys, but some of the more relevant results for incumbents from the papers are outlined below:

How many customers are Insourcing?

None of the papers give a view of the % of the total market being insourced. Instead they variously look at the % of respondents who have either insourced one or more previously outsourced contracts, are in the process or doing so or are contemplating insourcing;

- Warner & Hefetz said 22% of respondents had bought back services that were previously outsourced;
- Deloitte in 2005 asked if respondents had bought 'any' outsourced services back in house: 64% had;
- APSE didn't include a specific % in their 2009 report;
- Unisons report, based on an update by APSE of their 2009 report said 57% of respondents had either taken, were in the process, or were considering taking a service back in house.
- The Deloitte survey in 2012 found that 48% of their respondents had 'ever' terminated a contract for cause or convenience

Our view on these numbers is that, whilst insourcing certainly can't be seen from these surveys to be overtaking outsourcing as a trend or even making a significant dent in the growth of outsourcing, a significant number of customers at least look at it as an option in some situations – even if in most cases they don't choose that option.

Deloitte's 'Call on the outsourcing market' back in 2005 seems to have been premature based on the continued growth of outsourcing since then, indeed their 2012 survey says that outsourcing continues to go mainstream. We should also take into account the underlying attitudes expressed by those writing the APSE report – and particularly Unison (a UK trade union) who are generally not pro outsourcing. So we don't see a context at the moment where outsourcing will be reversed as a wider trend but we do see that contractors, and particularly incumbents, should take the specific findings of the research into account in how they manage and deliver their contracts (see below especially for what customers have expressed as their reasons for insourcing). There are certainly plenty of examples and case studies within the APSE and Unison reports to show that insourcing is happening. Indeed figures from other sources suggest that up to 30% of outsourcing projects can be seen to fail – albeit this figure is mainly for IT projects where the failure rate is seen to be higher than elsewhere.

Problems with outsourcing and reasons for insourcing

All the studies looked at the problems their respondents had with outsourced contracts, and some looked at the specific benefits respondents saw they gained when they insourced contracts. Not all gave specific figures for the relative importance of each factor, but where they did we'll summarise them below. Table 1 below summarises the issues and where they appeared in the different surveys. The headings for issues in the table are our own based on an amalgam of how the different surveys



termed the issues found in outsourced contracts, and the benefits claimed in the examples given of insourced contracts. Below the table we pick out some of these and give more detail of how they were expressed in the different surveys. We have created our own wider headings for where we feel these issues lie – which we believe will be of use when we look at the actions incumbents can take to address the issues raised.

Issues identified leading to insourcing from different studies					
Issue	Warner & Hefetz 2004	Deloitte 2005	APSE 2009	APSE / Unison 2011	Deloitte 2012
Service Quality	●	●	●	●	●
Costs	●	●	●	●	●
User / citizen satisfaction			●	●	●
Lack of added value / innovation		●	●		
Complacency		●			
Staff training / turnover		●	●	●	
Loss of flexibility			●		
Friction in value chain		●	●		
Loss of control		●	●	●	
Strategic / loss of knowledge		●	●		
Reacting to policy / competitive changes		●	●		
Cost of contract management / monitoring	●	●	●	●	

Table 1

Performance issues

Under performance issues we will look at those reasons for dissatisfaction with outsourced contracts which are largely within the ability of the contractor to resolve internally, though of course some will be impacted by the customer’s prior expectations, the format and specification of the contract the customer set and the basis of how they chose the winning contractor.

Service Quality

Warner & Hefetz cited 73% of respondents who had insourced a service as saying service quality not being satisfactory was one of the factors playing a part in the decision (the most common of all the factors cited). Deloitte’s 2005 study gave figures of 35% seeing underperformance as a risk, and 38% quoting Quality / Delivery as a problem faced. The Unison / APSE study quoted 43% of those who had insourced saying a need to improve service quality was critical to their decision. APSE quoted that key delivery targets were not being met and contractors were not delivering to required standards. Deloitte in 2005 quoted 57% of participants claiming best practices/ quality / innovation were major drivers for their outsourcing decision – but 31% of those participants said contractors became complacent once contracts were in place. In 2012 the Deloitte survey said 71% of those who terminated contracts gave overall quality of service as the most important factor in their decision.

Costs

Warner & Hefetz cited 51% of respondents saying cost savings of outsourced contracts were insufficient. 60% of respondents who had insourced cited the need to improve efficiency and reduce service costs as a key reason in the APSE/ Unison survey. The Deloitte 2005 survey goes into more detail on cost issues, quoting not only a failure to meet expected cost savings, but the impact of



'hidden' costs, a lack of price and cost transparency and cost increases during the contract (especially in response to any required changes in the contract) as key reasons for dissatisfaction. In the 2012 Deloitte survey pricing was quoted by 33% as the most important factor in their decision to terminate.

User / Citizen satisfaction

Or more accurately low levels of satisfaction were cited in the APSE and APSE/ Unison surveys as reasons for insourcing – and improvements in satisfaction were quoted in more than one of the case studies as resulting from the contract being insourced. Unison quotes 20% saying end user dissatisfaction had a part to play in their insourcing decision. In the 2012 Deloitte survey improving customer service or customer experience was the most commonly quoted factor (seen as very important by 62%) by those who had terminated a contract in their decision to insource the service.

Staff training / turnover

APSE and APSE/ Unison cite versions of this, combined with terms and conditions and subsequent low morale as an issue in outsourced contracts. Deloitte (2005) expand on this by quoting 22% of respondents experiencing vendor staff turnover leading to loss of knowledge and interrupted service delivery and a difference between the quality of 'sales' staff and 'operational' staff.

Flexibility issues

Flexibility issues (specifically a lack of flexibility) cover a range of the other problems respondents cited in the different surveys. Some were due to the structural changes putting a part of the customer's delivery of services under the charge of an outside organisation. But within this were also issues caused by a lack of flexibility from the contractors concerned. Below are some of the different aspects and variations of the flexibility issue raised in the surveys.

Friction in the value chain

This was a term only specifically used in the Deloitte 2005 survey, but one which could cover some of the issues described in the other surveys. By outsourcing one particular part of the delivery of services or one part of a wider process some customers experienced issues with the need to deal separately with the contracted service within that value chain, which either slowed or restricted their ability to make changes to or focus the wider value chain. The different focus and priorities of managers within the contracted service, the natural rigidity created by specifying and creating SLA's and KPIs to manage the contracted service, and the sometimes slow negotiation processes required to agree changes were seen as introducing friction into the wider value chain of delivery the customer operated and often relied on for market success. In addition in the APSE and Unison surveys one of the benefits cited by those who had insourced contracts was the ability to reorganise and integrate previously contracted services into other areas (of what Deloitte would have referred to as the value chain) or departments to deliver better synergies, cost savings, cross functional working and delivery of services

Loss of control

The inevitable transfer of control of the detailed delivery processes to the contractor was seen as causing issues for some managers in both the Deloitte (2005) and APSE surveys. And again the fact that managers and staff within the contracted service were reporting to a different organisation, sometimes seen as having different priorities, cultures and aims to those of the customer were seen as reducing the ability of the customer to effect changes when and how they were required.



Loss of knowledge and strategic capabilities

Some of the outsourced contracts, according to two of the surveys, were effectively outsourced 'by mistake'. Either through a lack of understanding of how the processes and departments outsourced really worked, or the impact they had on the customer's ability to deliver its core functions. Some customers didn't realise until they had already outsourced that they were effectively outsourcing core strategic aspects of their businesses. Deloitte (2005) quote nearly 20% of their respondents saying they had insourced contracts that they realised after outsourcing in fact contained 'thought leadership' and imbedded strategic knowledge. Some of the cited results of outsourcing strategic functions led to a loss of key knowledge from the customer to the contractor, or the inability of the customer to deliver core functions in the way it needed to meet its objectives. When combined with the need to adjust the work delivered on the contract due to changes in the customer requirements, environment or drivers (see below) this was seen as a significant issue leading to a number of contracts being taken back in house.

Reacting to policy / competitive changes

As was outlined in some of the areas above which were raised in the surveys, the rigidity caused by the act of contracting a particular part of a customer's delivery chain was seen as an issue by respondents and a cause for them to insource contracts.

This was particularly acute when either external policy or measurement regimes changed (for instance by changes in Government policy, targets or measurement regimes for Local Authorities covered in the APSE and Unison surveys), or competitive pressures and initiatives in the private sector (e.g. those surveyed by Deloitte in 2005) meant the form of delivery or terms on which the original contracts were outsourced required significant change. This could be new, higher targets for delivery being set on Local Government which were not included in the contracted out SLAs or KPIs, changes in focus of what was required of the service (for instance the need to move emphasis of waste collection services to significantly enhance recycling was cited in APSE and Unison examples). Or it could mean the need to reorganise or upgrade the performance or way of working of a contract to deliver in line with new competitive initiatives, use of technology or new products/services, or pressures faced by the private sector customer.

The inability, cost or time required to negotiate changes to contracts – or the need to completely change, or cut aspects of the contracted service or combine it with non contracted services could lead to critical failures in the customer business. In some cases this led to poor performance in league tables by Local Authorities or even fines for non delivery to the new regime. For private sector customers it could lead to competitive disadvantage and loss of market share.

Cost, time and expertise to manage contracts

The cost, management time and disruption of effectively procuring, monitoring and managing contracts and contractors to ensure they delivered to requirements was seen as a separate factor in insourcing contracts, but one with a number of facets. Warner & Hefetz found that problems with monitoring contracts was a factor in the decision to insource for 20% of respondents. Deloitte (2005) said that 63% of their participants had found managing outsourced relationships required more management effort than anticipated, and that new skills were required by managers to ensure contractors delivered effectively. As a related issue, Deloitte particularly focused on the issues customers faced with negotiations with contractors and the shift in bargaining power to contractors once they had taken on the contracts – especially longer term contracts. In some cases this shift was seen as a major issue leading to price increases through the contract, especially as a result of negotiations where changes were required to meet changes in customer requirements.



Responses by customers to the problems found

Customers insourced contracts either at the end of the contract period, or where problems were particularly severe through terminating the contract early. But in most cases this followed a process of either benchmarking against in house capabilities (in the APSE and Unison surveys customers sometimes found that internal capabilities to deliver had risen to levels that could deliver better than the contractor), or looking at a range of alternatives including extension of the contract (with negotiated changes of service as a part of the requirements for the extension), rebidding or insourcing.

Other responses included (particularly from the Deloitte 2005 survey):

- Renegotiating contracts (83% of respondents);
- A move from longer term contracts to shorter term contracts (53% of respondents) - to reduce the issues of lack of flexibility and contractor negotiating power;
- Sourcing multiple contractors to deliver the service/ product (73% of respondents) – to maintain ongoing competition and options during the contract and for the rebid;
- Increased due diligence prior to the decision to outsource further contracts – to ensure the processes to be outsourced were better understood;
- Increased due diligence of contractors – to ensure the right contractor was chosen;
- Introduction of more proactive gainshare provisions in contracts (43%) to motivate innovation;
- Requirements on contractors to train and develop staff.

These reviews and reactions to problems, when they occur during the contract period, should be a clear warning sign to incumbents that things are not right for the customer.

What can Incumbents do?

There are obviously factors that are outside the ability of incumbents to influence which can lead customer's to insource, either issues with their own pre procurement or procurement processes or some factors relating to their wider organisations. But there are a lot of things incumbents can do to reduce the risks of the customer insourcing – or terminating the contract early and rebidding it. Unsurprisingly a number of these are similar to the things an incumbent should be doing anyway to put themselves in a better position to win their rebid in 'normal' circumstances.

Below is a summary of some of the actions and approaches incumbents can take. A fuller version of this analysis and advice is included in an extended version of this paper in the Rebid Centre. We will also refer in this summary to ideas and actions which are detailed in the Rebid Guide. For details of the Rebid Centre and Rebid Guide go to <http://rebidsolutions.co>

Performance issues

The simple answer to the most common issue regarding performance quality is – meet your KPIs. But in truth there is more detail to the solution. There are a number of things you can do which will help beyond just delivering to the KPIs set:

- At the start of the contract check with the customer what they really want – this might not be properly captured in the KPIs and SLAs set (see idea 2 in the Rebid Guide)
- Check what was promised in your bid and ensure you work with the customer at the start of the contract so they are confident you are actually delivering on your promises (see idea 3 in the Rebid Guide)



- To ensure you are meeting end user and other stakeholder needs and improving satisfaction set up your own surveys (or at least pay attention to the customer's surveys) – and act on the results you get (see idea 14 in the Rebid Guide)
- Always be looking for ways to improve what you are delivering – focusing on the most important needs which are impacting on the customer not just locally but strategically (see the Improve section of the Rebid Guide and all the ideas within that section)
- As part of your continuous improvement, added value and innovation drive, look at how you can share the gains with the customer. This is more about an approach than an action particularly. Some incumbents in the surveys clearly focused only on their own margin improvement and organic growth when settled into the contract. Sharing the gains you make with the customer can help your own growth and margins – but also ensure the customer gains (see ideas 15 – 17 in the Rebid Guide). Improvements should again be focused on what is important to the customer. If that is cost then focus on things you can do to reduce costs – for the customer as well as yourself.

Flexibility issues

Flexibility issues can be more complex to manage. Not least because you may as the incumbent be tied to contractual terms and processes set by the customer which don't help flexibility. However many incumbents over play this issue and it can become more of an excuse than a genuine reason not to flex delivery as the customer's needs change. For others change control processes are also simply seen as a route to gain increased profits. As we have said above this is a matter of approach as much as capability or contractual restriction. If you have a culture of sharing benefits with the customer rather than simply taking every opportunity just to maximise your own short term profits you are likely to find you can flex the contract significantly without losing profit and be less likely to have your contract insourced (and much more likely to win your rebid). See for instance ideas 19 and 21 in the Rebid Guide).

The issues around how contracts cause 'friction in the value chain' may seem to be outside the remit of the incumbent contract team. But there are things you can do to reduce this and the related flexibility issues.

- Understanding the customer's strategic aims and most important requirements and focusing your improvement and delivery efforts (and your performance measures) on these will make a real difference to the view of your contract as a valuable part of the whole customer organisation (see for instance the introduction to ideas 15,16 and 17 and also idea 12 in the Rebid Guide – which you can also download as part of the free examples of ideas in the Rebid Guide from <http://rebidsolutions.co/rebid-guide>)
- Forming a clear understanding of the customer's wider aims and the processes and elements of the wider value chain you can impact through your contract will also reduce this 'friction' (see our paper in the Rebid Centre on 'Helping deliver the customer's wider aims')
- Constantly keeping your contract up to date with the customer's requirements – rather than just delivering what was in your original contract will also help you keep the contract flexible to changing customer needs and working with the customer to make the most positive use of the contract change routes available will also help(see ideas 19 and 21 in the Rebid Guide).
- And ensuring you build and maintain relationships with a wide range of stakeholders across the customer organisation, and act on what their needs are where you can will also mean you are taking a wider view of the customer's overall delivery and strategic requirements (see idea 22 in the Rebid Guide)

Finally, customer's rarely terminate contracts, or decide to insource them at the end of the contract term without significant thinking and work being done prior to taking action. If you are close to your customer you should be able to see the warning signs. If you have worked to build positive and open



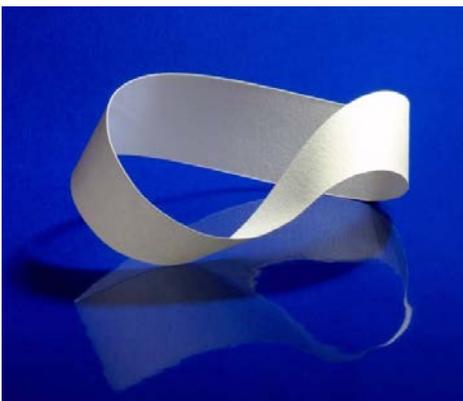
relationships and trust with customer contacts and stakeholders you should become aware of these issues early. Rather than ignore them, be proactive. Potentially there are changes you can make to put off or even change the decision. You may even be able to become part of the process if you have managed to become a trusted advisor to the customer. Even if the issues the customer faces are outside your ability to resolve through delivery and flexibility on the contract, it may be you can help the customer redesign the contract for the next period – and put yourself in a better position to persuade the customer to rebid on these terms rather than insource – and of course be in the ideal position to win that rebid.

References

The surveys and papers we have drawn on for this paper are all available publicly and can be found via Google searches. Here are the addresses where we found the papers. There may be other routes to find them elsewhere.

- **Pragmatism Over Politics: Alternative Service Delivery in Local Government.** Published in 2004 and written by Mildred Warner and Emir Hefetz
<http://www.municipalservicesproject.org/sites/default/files/72.pdf>
- **Calling a Change on the Outsourcing Market.** Published by Deloitte Consulting in 2005.
<http://www.syllogos.gr/links/docs/OutsourcingStudyRV1.pdf>
- **Insourcing: A Guide to Bringing local Authority Services Back In-House.** Published by the Association for Public Service Excellence (APSE) in 2009.
<http://www.apse.org.uk/page-flips/2011/insourcing/files/in-sourcing.pdf>
- **Insourcing Update: The value of returning local authority services in-house in an era of budget constraints.** Published by Unison in 2011
<https://www.unison.org.uk/upload/sharepoint/On%20line%20Catalogue/20122.pdf>
- **Deloitte's 2012 Global Outsourcing and Insourcing Survey (executive summary)**
http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/IMOs/Shared%20Services/us_sdt_2012GlobalOutsourcingandInsourcingSurveyExecutiveSummary_050112.pdf

This paper is one of many you will find in the Rebid Centre. All the ideas we refer to in the paper are more fully described in the Rebid Guide and the Rebid Centre, together with step by step guidance of how to put them into action on your contract and rebid. You will also find papers and advice on all aspects of how to prepare for and run your rebid. To join the Rebid Centre, or buy the Guide go to www.rebidsolutions.co



Rebidding Solutions helps incumbents win their rebids. As well as providing articles, advice and processes for incumbents in the Rebid Centre we have also published the Rebid Guide which contains 60 ideas for incumbents to put into practice from day one of their contract to improve their chances of winning their rebid. We also provide consultancy and bespoke training for incumbent companies and contracts, helping them put together the processes and actions that lead to rebid success.

For an overview of all our services visit our website at www.rebidding.co.uk and sign up to our free newsletter giving hints and tips on what to do to win your rebid.