

SECURING VALUE FOR MONEY IN  
OUTSOURCED CONTRACTS

# How Local Authorities Can Deliver Their Cost Reduction Remit

Roger Warner, ISG



## INTRODUCTION

Local Authorities could be losing some 15-20% in annual contract value by not actively managing the benefits realisation of outsourcing contracts. This white paper, based on ISG's experience in reviewing existing IT and business process third party agreements within local government, explains how to assure continued value for money throughout the life of the contract through Benchmarking, Contract Review and by adopting pro-active Service Integration and Management (SIAM) best practices.

## INTRODUCTION

The media spotlight is ever more focused on the real value for money being delivered by outsourcing contracts awarded by local authorities. This focus is partly driven by the ongoing reduction in central government funding of Local Authorities, but is also impacted by an increased focus in achieving operational efficiencies across the public sector and providing better public services at a fair price.

As a result, there is now a strong demand for more transparency around existing third party contracts from both the regulators and from the public, to ensure value for money is being achieved.



**Spending wisely may matter more than spending less.**

Typically, the responsibility for demonstrating good service delivery at a fair price has lain with the service providers. However, there are also significant opportunities for Local Authorities themselves to reduce costs and improve services by more effectively managing their contracts and suppliers.

Crucially, to achieve all of the benefits expected when outsourcing public services requires proactive management and an 'end-to-end' review of service delivery, including the governance and service management processes within the Local Authority. Devolving responsibility to the service provider is not enough. In short, to concentrate solely on spending less is to ignore the opportunity to improve the service while still reducing costs and to shift the focus to spending wisely.

## CHARTING THE JOURNEY

Outsourcing is nothing new in the public sector and Local Authority managers are fairly experienced in managing the process and understanding the potential benefits. Indeed, in recent years there has been a significant increase in the number of Local Authorities outsourcing both IT and business processes, often to a single supplier, with a view to reducing costs and leveraging the latest technologies to streamline public services.

The next challenge for Local Authorities is to move on from the contracting phase and fully mature their use of outsourcing by proactively managing all of their sourcing arrangements to ensure that they:

1. Have credible, reliable and validated data upon which to base management decisions.
2. Use all available contractual tools to ensure value (for example, XX% of benchmarking clauses are never invoked).
3. Track all contractual Deliverables and Obligations – in both the transformation and steady-state delivery of services.

## SECURING VALUE FOR MONEY IN OUTSOURCED CONTRACTS

By addressing these three areas, with the support of trained teams, efficient processes and effective tools, Local Authorities can start to demonstrate that their current outsourcing arrangements are performing well and delivering all of the benefits envisaged. Furthermore, by focusing on these areas they will remain competitive with the current market and have the ability to unlock further value from their sourcing strategies.



**Without transparency around costs, many Local Authorities have no idea whether they are being charged a fair price.**

## **IDENTIFYING AND ADDRESSING OBSTACLES**

Many companies providing services to Local Authorities charge a single, fixed price for delivering a bundle of complex services and offer little or no transparency around the costs of delivering specific service elements. As a result, many Local Authorities have no idea whether they are being charged a fair price. This situation is often exacerbated by the fact that these fixed prices were negotiated a number of years previously and bear no relation to current market trends.

Relying solely on the service provider to provide a 'good deal' in this way is clearly not enough. Authorities must ensure that they manage both the service provider and their own users effectively to ensure value for money. Common obstacles include:

- 1.** Invoicing errors - typically characterised by over/under billing, usually in the supplier's favour. This commonly occurs when invoices are not checked carefully and where invoice validation is not undertaken.
- 2.** Obligations and deliverables that are not met - including contractual obligations that are never delivered which suppliers may quietly 'forget' unless the client checks and insists on delivery.
- 3.** Poorly managed inventory or capacity - resulting in clients being charged for services that are not actually being used (examples include laptops not returned; active network ports that are not used; excess storage or processing capacity in excess of actual requirements).
- 4.** Uncontrolled demand/customer behaviour - a lack of visibility to the end user of the costs of the service can lead to 'uncontrolled' purchasing. If users do not know the costs, or perceive that the cost to them is nil, they will demand and order more services, even though there is a real cost to the enterprise as a whole.

## **STEERING THE RIGHT COURSE**

Local Government outsourcing contracts generally encompass multiple disciplines including both IT and business processes (such as HR, Finance, Revenue & Benefits, Procurement etc.). There are three major techniques that should be employed to ensure that these contracts continue to demonstrate value for money.

## **SECURING VALUE FOR MONEY IN OUTSOURCED CONTRACTS**



Three major techniques should be employed to ensure that contracts continue to demonstrate value for money.

**Benchmarking** looks at the **current** value for money for a contract: A competitive price negotiated three years ago may now be completely out of step with the market price for such services. It is important to take into account current market trends for both IT and Business Process Outsourcing (ITO and BPO) services to establish today's fair market price for the services delivered and to use this to reset pricing as contracts allow.

For example, ISG studies have shown that prices for ITO and BPO (such as Revenues & Benefits, HR etc) services are falling annually by 4% and 3.5% respectively. Price re-negotiations need to take this trend into account to ensure that the organisation is paying a fair market price across the length of any contract.

Benchmarking can also yield additional qualitative benefits including the sharing of best practices across Local Government which can support the shaping of appropriate client sourcing strategies.

**Contract Reviews** allow the organisation to compare the strength and utility of their outsourcing arrangements to the market and then review this alongside the benchmarking results. This technique can reveal potential issues such as services that may have met the value for money brief originally but have since slipped, clauses that give the client very little flexibility in the face of change or those that leave significant risks or liabilities with the client.

For example, many contracts only allow benchmarking comparison against the market mean, rather than top quartile pricing - which ISG considers best practice.

Other important areas to consider within the Contract Review are:

1. Productivity Improvements.
2. Service Credits.
3. Financial Responsibility Matrix.
4. No minimum Commitment.
5. Retirement of Service.

A robust contract review will look at over 200 contract clauses and also report against best practice from a contract benchmarking database.

Finally, **Service Integration and Management (SIAM)** is a set of defined roles, processes and responsibilities that help shape and govern the client team (known as the Retained Organisation) and their relationship with the supplier. ISG has developed a robust and proven SIAM approach that addresses the following areas:

|                      |                                                                                                                                                                                              |
|----------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Transparency         | A lack of end-to-end and cross-Supplier service transparency due to inconsistent or unclear service reports, boundaries, complex Service Portfolio cutting and outsourced bundles            |
| Accountability       | Often accountability (roles & responsibilities) unclear after sourcing out services to Service Providers and this is critical for contractual compliance and uninterrupted service provision |
| Communication        | Escalation and communication mechanism throughout the Customer and Supplier groups not well communicated and/or unclear, not followed or shadowed                                            |
| Compliance           | Compliance with contractual agreements, regulatory requirements, industry standards and business objectives increasing the pressure on retained IT organizations                             |
| Service Excellence   | "Green SLAs, Red Faces": Individual Supplier component services may be meeting SLA targets, but the business s, or consumers of IT, are experiencing disjointed services                     |
| Sourcing Flexibility | It is difficult to take advantage of new services from suppliers due to the time and cost of introducing those suppliers and services into the environment                                   |

## TAKING CONTROL OF THE JOURNEY

Local Authorities should use the tools outlined above to help them ably demonstrate that they are fully in control of their outsourcing contracts and are achieving the best possible value for money from their sourcing arrangements.

- 1. Benchmark each service tower** within the contract against market prices to assess whether services really are value for money. Even if there is a single fixed price for a bundled set of services, it is still possible to compare the price to a Reference Group of similar organisations by understanding the quantity consumed for each service element, multiplying this by a market price and aggregating the total prices. Remember that both IT and Business Process services show a general downward trend in market pricing over time and this needs to be taken into account if contracts are being renegotiated.
- 2. Review the Contracts** – ensure that all contract terms are fit for purpose and that they give sufficient agility and flexibility to meet changing market and budgetary demands whilst looking at service provision as an end-to-end view to optimise value.
- 3. Assess the Retained Organisation** – for capability, efficiency and maturity in the way in which it manages the supplier relationships and assures that the full benefits of the sourcing arrangements are being realised.
- 4. Build a Strategy** – for moving to services procured through the G-Cloud; you can't get there in one leap but there is increasing pressure to utilise the centrally negotiated services where possible.



**ISG's proven approaches to Contract Review and SIAM Assessment take advantage of our unique data sets.**

## **FINDING HELP**

ISG has considerable experience in assessing value for money from outsourcing contracts for Local Authorities and Central Government departments. In particular ISG has expertise in assessing IT, HR, Finance, Procurement and Revenue & Benefit contracts, identifying cost savings for some clients of up to 20% of annual contract value. Our proven approaches to Contract Review and Service Integration and Management Assessment are market leading and take advantage of our unique data sets based on actual contractual performance.

## **CONCLUSIONS**

Outsourcing alone will not automatically lead to good value for money. Achieving the best results from these arrangements demands clearly defined governance and supplier management processes within the Retained Organisation. Furthermore, a clear understanding of fair market pricing allows government clients to negotiate effectively with their suppliers.

As a result, key decisions can be made based on clear, unassailable factual information, allowing Local Authorities to obtain optimal pricing for services delivered across a broad of range of towers, throughout the life of the contract.

With current pressure from the Government, Regulators and Tax Payers to reduce costs, obtaining this level of visibility and transparency is vital to ensure costs are managed effectively, now and in the future.

## **Local Authority Case Study**

*"The professionalism of the ISG project leads and resources was very high, and the quality of the deliverables [...] was also very high"*

**– Service Provider Commercial Manager**

### **A Combined Approach to Benchmarking**

ISG was engaged jointly by a UK local authority and its service provider to perform a benchmark on a key set of business services that were outsourced to the service provider. The in-scope services included Information and Communications Technology (ICT), Human Resources (HR) & Payroll and Revenue & Benefits. The business services formed part of a 7 year contract that had 2 years of the initial term remaining. In addition to benchmarking existing services the Authority wanted to assess the opportunity for extending the contract by up to 6 years.

### **Modelling Current and Future Price Comparisons**

ISG gathered key data from the client about the cost and quality of service delivery across the in-scope services. Using a proprietary set of models, ISG mapped the client data to its extensive database of performance data to allow direct comparisons to be drawn between the client and comparable organisations receiving a similar set of services. The ISG team then developed a 5 year forward-looking price model for each of the three service areas to establish a future price benchmark, providing the Authority with a means of assessing the contract extension proposals offered by the service provider.

### **Establishing Areas of Excellence and Improvement Opportunities**

ISG found that all three services represented value for money compared with the average prices in the reference group, with HR & Payroll performing particularly well. Prices in the Revenue & Benefits and ICT service areas, however, exceeded top quartile prices by almost 5% annually, equating to more than £11 million per year. This, coupled with cost reduction trends across all services over the next 5 years, offered a significant opportunity for the Authority to reduce its spend on business services in the short to medium term.

Specific opportunities were also identified in the cost of application development projects being delivered by the service provider. Whilst the rate card benchmark found day rates to be reasonable, staff ratios at some levels appeared to be excessive, which drove up project costs for the Authority.



### **Fact-based Approach Ensures Transparency and Trust**

The results of the benchmarking exercise delivered a reliable, fact-based analysis of the value for money of the in-scope outsourced services. The Authority has been able to use the results to negotiate with the service provider for improved pricing to close the gap between its current state and top quartile performance.

In addition the cost trend data provides the Authority with valuable supporting data for future contract negotiations. Equally the service provider has a transparent view of its client's pricing intentions helping it to pitch future business at a winning level, and set expectations internally.

### **Further Opportunities in the Retained Organisation**

Following the success of the benchmark the Authority independently engaged ISG to perform a deeper analysis of its retained organisation in order to identify further efficiency improvements. Specifically, ISG reviewed the service management and governance (SM&G) of the outsourced services and any related value leakage, as well as the identification of further outsourcing opportunities within the in-scope business services. The analysis concluded relative maturity and effectiveness of the Authority's SM&G processes. It also identified a number of opportunities where further outsourcing in the HR function could deliver additional value. Crucially, the review highlighted necessary improvements to inventory management to help the Authority avoid procuring services that are subsequently not used. Over-procurement was being driven by lack of end-user visibility of the cost of services, so ISG recommended implementing a consumption-based pricing arrangement to overcome this. Consumption-based pricing has the potential to deliver up to 15% savings of the annual contract value, or more than £4 million per year in the case of this Authority.

### **A Win-Win Outcome for Both Parties**

Conducting an independent benchmark of services, delivered by third party service providers is the only definitive means of establishing whether an organisation is receiving value for money. Working closely with both the client and the service provider, ISG was able to apply its impressive sourcing advisory experience and world-leading database of performance data to not only identify performance deltas, but also recommend how to close the gap efficiently and effectively. Focusing on both current state and future trends ensured fair reflection of 'as is' and 'to be' pricing and supported end-of-contract decision making and discussions. Ultimately, the Authority has been able to implement a number of internal cost saving programmes and both the client and service provider have entered contract discussions with transparent pricing information based on market rates and without the need to initiate discussions with other third parties. Ultimately working with ISG has benefitted both parties by helping to avoid the cost and distraction of a re-tender whilst also conducting a fully independent value for money review of the services.

## ABOUT THE AUTHOR

### **SECURING VALUE FOR MONEY IN OUTSOURCED CONTRACTS How Local Authorities Can Deliver Their Cost Reduction Remit**

Published June 11, 2014



#### **ROGER WARNER**

Principal Consultant

Roger brings extensive business process experience in both the retail banking and life and pensions sectors after consulting for decades with some of the most-well-recognized global banks. His knowledge of lending and customer service operations, cross-border payment processing, ATM management and pensions administration extends to experience in the U.K. public sector, where he focused on diagnostic and transformation projects. Roger holds a bachelor's degree in economics from Leeds University and a master's degree in computing from North London University. His articles on retail banking have been widely published in the South African press, and he has written several white papers on front- and back-office performance improvement.



## ABOUT ISG

**ISG (Information Services Group)** (NASDAQ: III) is a leading global technology research and advisory firm. A trusted business partner to more than 700 clients, including 75 of the top 100 enterprises in the world, ISG is committed to helping corporations, public sector organizations, and service and technology providers achieve operational excellence and faster growth. The firm specializes in digital transformation services, including automation, cloud and data analytics; sourcing advisory; managed governance and risk services; network carrier services; technology strategy and operations design; change management; market intelligence and technology research and analysis. Founded in 2006, and based in Stamford, Conn., ISG employs more than 1,300 professionals operating in more than 20 countries—a global team known for its innovative thinking, market influence, deep industry and technology expertise, and world-class research and analytical capabilities based on the industry’s most comprehensive marketplace data. For more information, visit [www.isg-one.com](http://www.isg-one.com).

Let’s connect **NOW...**

