Outsourcing to Right-sourcing of (Facilities) Services and Management

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Introduction

1. Introduction

After twenty-seven years of experience within Facilities and Services Management (predominantly workplace, operations and maintenance, energy, security, cleaning, catering, reception, office services, pest control, grounds and landscaping, etc.), provision and sourcing, (six years within two client organisations and twenty-one years within two global supplier organisations), I have now decided to become an independent advisor.

I have seen procurement of services and services management generally undertaken in either of the following ways:

1) **Sourcing** – services are procured to input specifications (task, frequency and volume) for specific assets, areas and, or buildings. The customer retains the management responsibility for these specifications, plus any extra variable and or reactive services required to meet the outputs and outcomes required by the core business. This approach is often associated with parallel self-delivery of some services by the customer organisation. It is from this approach that a first-generation outsourcing usually evolves.

2) **Outsourcing** – management responsibility to deliver services to agreed outputs (e.g. response times, equipment availability, satisfaction ratings, etc.) or outcomes (production or critical environment up-time, employee retention, brand enhancement, reduced total cost of occupancy/ownership, etc.) to an aggregated cost is passed to the supplier. This is often only viable where services, assets, areas and buildings are bundled so that the customer can consolidate and reduce their own related management organisation.

This paper focuses on the latter category, as I have been directly involved in over thirty outsourcing contracts and around the triple in proposals, ranging from local to regional and global scopes covering many hundreds of millions of Euros in annual volumes.

My journey to date has been an interesting, exciting and rewarding one, supporting a relocation of my home base between the UK and Sweden (and hopefully soon to Portugal) and an expansion of my working arena from the UK to Scandinavia, Europe and then Global. I am truly thankful and grateful for the company and engagement of all I have met and worked with along the way.

However, as outsourced Facilities Management and Services contracts enter third and fourth generations, evolution appears to have reached a point of inflection, driven by seemingly ever-increasing market expectations which now may be further exaggerated because of COVID-19.

"No longer being part of a parent organisation demanding consideration of stakeholders and their related interests, allows me this opportunity to candidly describe my observations on practices and behaviours that in my opinion, should be improved for the benefit of ALL within the industry."

Such improvements would also benefit the wider businesses and communities dependent upon healthy sustainability and evolution of the related services and suppliers.

Where examples from actual situations are provided, the names of individuals from suppliers, customers and consultants along with their organisations, are withheld in the interests of confidentiality and good professional conduct.

I emphasise that these are my personal reflections only and as such should not be deemed to represent any views or opinions of any of the organisations or individuals I have been associated with to date.

This paper then proposes a new approach, 'Right-sourcing' that will maintain the strategic value of outsourcing whilst incorporating the recommendations herein.

This paper will be of interest to anyone working and/or researching in this field. Whilst predominantly reflecting my experiences within the Facility Management and Services industry, they may have parallels in the sourcing of any service.

2.
Summary

2. Summary

It is my belief that outsourcing non-core activities is a sound strategy for most businesses. However, as the market has matured over the last twenty years, focus on cost reduction as the principal driver of value, coupled with increasingly sophisticated expectations of risk transfer to suppliers is creating an untenable situation.

In recent years procurement organisations have come to market with direct cost savings expectations close to or even greater than those expected in first generation agreements, coupled with increasingly higher risk transfer to suppliers in relation to penalties, balance sheet, cash flow, insurances and warranties, termination, etc. Furthermore, service levels are often increased to a “wish list” based on best possible theoretical performance that does not reflect the actual pre-outsourced situation. Focus and downward pressure on supplier margins with little consideration of equity between the value provided by outsourcing versus the effort required of the supplier or degree of self-performance versus sub-contracted services (and hence opaque margin within the supply chain), often results in below-market viable margin percentages being included in final contracts.

Inappropriate behaviour then arises as supplier organisations try to remain profitable. Customers try to force through a delivery of promised transformation, suppliers struggle to meet promised data-driven and innovation-related expectations and parties take on risks on paper that may not be covered in practice. Paradoxically, in the early days of first generation outsourcing, when the market and competition was less mature and before the event and availability of dedicated procurement, consulting and legal services;the financial and volume baseline information shared in request for proposals (RFP) from customers, appeared to be of a better depth and quality than today. This is especially prevalent with respect to fixed versus variable costs, opex versus capex, and associated volumes. Direct savings expectations compared to such baselines need to remain credible; expecting the scale of savings from earlier agreements to be continuously repeated on a like for like basis in later generations of agreements is not. Agreement and acknowledgement that suppliers then also need to generate margins to ensure reasonable operating profits (5% to 7%), is also important to sustain healthy contracts and related ecosystems.

Another requirement of outsourcing, is that the supplier will implement a management structure relative to the services being their own core business. This shall include personnel and processes as well as automation of the associated workflow, information capture and reporting via IT solutions, that will then support continuous improvements. The customer can then consolidate appropriate to the degree of outsourcing of management to the supplier, moving from direct to indirect management accordingly. The internal cost and operational benefits of such change to the customer organisation, needs to be considered within the overall evaluation of the outsourcing business case. To support such change, Right-sourcing should include, ‘charters of behaviour’ into the contract terms, to promote alignment and governance between the Parties’ respective workforces and management interfaces.

Then with respect to supporting IT systems there are myriads of possible solutions. Due to the complexities of implementation across multiple services and sites, the challenge of engaging personnel in using them and the rate of market evolution, an eco-system of interconnected, supplier and customer expert systems is recommended, over a general IT platform panacea. Here the customer should develop and retain management of an IT road-map that defines required data fields and outputs as required for short-term needs, whilst building in agility for future changes and integration further down the road.

2. Summary

Another challenge related to outsourcing projects, is staff often transfer. Regardless of whether from customer or third-party suppliers, around 20% of transferees will be high-flyers, 60% will basically perform as they did pre-transfer and 20% will need some form of performance management. On top of this, suppliers must take on balance sheets and other risks associated with personnel, that in many cases are unknown until transfer and customers may demand special protection for transferees from the customer organisation.

Right-sourcing should therefore moderate commercial expectations with these requirements, risks and realities. Bearing in mind that often the majority of savings must come from reduction in labour whilst Corporate Social Responsibility and Brand Protection is an increasing focus for both Parties. Focus and downward pressure on rates of pay should be stopped in favour of focus on the direct and indirect benefits of the sourcing solution.

Outsourcing contracts are usually between three and five year terms, in order to allow time to make the required transformations. Whatever form of commercial agreement and contract is established, whilst it is reasonable to include terms that discourage suppliers from doing so, both Parties should be allowed to terminate for convenience in a timely and professional manner; allowing the other Party enough support to survive such termination. Most agreements, especially more recent ones, only give such rights to the customer which I believe is often the cause of inappropriate behaviour later in the term.

In conclusion then, to maintain a sustainable market and the strategic benefits, we need to introduce a Right-sourcing approach to outsourcing.

It is my opinion that in general there needs to be:

- More time spent in preparation and lower direct savings expectations, in favour of credibility and viability, as well as the indirect benefits of outsourcing (or review insourcing over outsourcing strategy).
- Suppliers and customers need to be more open and honest about gaps and uncertainties and include appropriate mechanisms for validation and reconciliation in contract agreements.
- Suppliers need to be able to realise market margins equitable to the risks and effort taken on, as well as the overall value of outsourcing to the customer.
- To avoid potential unreasonable decision making, supporting procurement, consulting and management functions, should be engaged and remunerated on the longer-term results of contracts and not just the initial deal.

3.
Objectives and Expectations of Sourcing

3. Objectives and Expectations of Sourcing

In the early 90's in the UK and later in Scandinavia (I started working in Denmark in '96), outsourcing of facilities management was in a "first-generation" situation whereby organisations were moving from self-performance and, or multi-suppliers, working on input specifications dictated by customers, manufacturers and, or, consultants. Suppliers of integrated, output-driven management and services solutions were limited, as was the related experience of consultants, procurement, commercial and finance, human resources and legal support. As a result, consideration and design of outsourcing models followed a robust discussion around the strategic benefits of focusing internal management and support functions on customer core-business whilst sourcing the rest through third parties who would approach these non-core areas as their own core-business:

"Care was taken to understand financial, services and organisational baselines as much as possible, allowing time to discover pre- and post-supplier engagement including mutual review and verification by the incoming supplier."

Time allowed for the internal and external engagement prior to establishing an agreed commercial and operational baseline would typically be at least between 18 to 24 months.

A great example of strategic sourcing in my earlier experience in 1997/8 was where the customer wanted to use facilities management outsourcing to support a rebranding and merging of company culture between the recently acquired Danish IT services company and its local smaller but significant sibling.

The American parent needed to create a one-company culture as a key milestone to realise return on investment. They recognised that using outsourcing to provide merged non-core functions would offer the least path of resistance to a re-branded and harmonised workplace experience, providing both an example to and driving change in the core business.

Savings were important but not in themselves the end-goal. In these very early days there were no real international competitors to my organisation in Denmark so this was a direct negotiation.

The approach on both sides was consultative, honest and robust. The process was anchored with the executive management and then supported by some key managers within the intended contract interface that acted extremely professionally whilst never being certain on which side of that interface (if at all) their positions would end up.

It took around six months to reach a contract agreement based on reasonable savings stated and agreed at the outset, but with detailed plans on transformation developed along the way, including the treatment of transferring personnel. Much of the required information was discovered jointly and agreed transformation challenges mutually designed and tested with the executive steering group on an on/going basis. Six months post transition verification was also included. The result was a success leading to a very long-term relationship that later spawned a global agreement (and both managers ended up working within my Danish management team!).

At a later date, I was faced with similar sourcing goals myself, as a customer for a large Nordic financial services organisation. Facilities services were predominantly delivered in-house in Norway and outsourced in Finland with all manner of hybrids in between in Sweden and Denmark. A significant internal structure then managed the services to input specifications with little, or no harmonisation to performance or commercial evaluation between countries and no supporting IT platforms. Whilst direct savings were a goal and acknowledging that an internal solution would probably target similar savings, it was agreed that the indirect benefits of outsourcing would be greater and faster. It took a year of internal review to derive a common understanding, description and baseline of services, volumes and costs, prepare for tender and anchor with stakeholders. The proceeding tender exercise and transition then took another year to establish. An internal proposal was included in the process which came close to external providers with respect to savings but lacked operational transformation ideas and credibility.

Considering the efforts required from the management in my own team, HR, legal, finance, procurement and external consultants, then the resulting investment took at least two years to recover in direct savings but the impact on culture and core business was immediate, significant and impressive.

These good examples acted as a compass for my future engagements.

3.1 Cost saving

In the first generations of outsourcing, savings were predominantly supported by a shift from input to output specifications, introduction of related service and workflow management systems and consolidation of customer and supplier management and administration.

Whilst savings were always required, it was understood that suppliers had to make margin, whilst also investing in the establishment of management resources, processes and IT solutions required as“core-business” alongside accepting cost, restructuring, services and contract liabilities. As a result, direct cost savings generated were unlikely to be any greater than that possible internally. However, compared to an in-house option, the indirect benefits of the sourcing activity would be realised as well as the direct benefits of risk and liability transfer, coupled with a much faster, predictable and accountable implementation of the equired transformation.

Allowing for reasonable margins to the suppliers within the outsourced solution, direct savings expectations of a typical five-year term contract, generally fell into a pattern of around 10% year one to around 20% in the final year. These targets were then subject to mutual and transparent negotiation and agreement around related mobilisation, implementation and restructuring costs. Customers acknowledged the concept of “total supply chain margin”, recognising that each service provider must make a reasonable margin on their revenue in order to realise a representative target profit before interest and tax of typically 5% to 7% (at expected service performance). The sourced structure would include a mix of principal supplier with sub-contracted and managed agent type services, depending on the management and self-performance capacity of the supplier and potential to transform the services undertaken. For example, a highly input specified and partially customer delivered cleaning or maintenance service would be undertaken as a principal service by the new supplier (possibly wholly self-performing but also likely with a degree of sub-contracts) and management of demand-side energy, postal charges and office supplies would be under a managing agent solution (not invoiced through the principal supplier). As the outsourcing concept has become established, so have supporting approaches in procurement, commercial and legal engagements. There has also been considerable growth in the availability of suppliers of consulting services, facility management and services. This has evolved levels of outsourcing, and led to increased expectations and competition.

Most of the objectives stated by customer organisations in later years, remain as in first generations of outsourcing. Cost savings are nearly always declared as not being the main consideration at the outset of the sourcing exercise yet predominantly becomes the most significant basis of comparison and final down-selection between suppliers bidding for the contract.

3.1 Cost saving

It is not unusual for suppliers with favoured operational solutions to be pushed towards lowest bidder prices, even where these are significantly lower than the mean values of all other bids.

As a result, final cost savings expectations related to second and third generation-plus outsourcing contracts, appear to be remaining the same, and in some cases, even greater than those targets in the first generation. This may be due to perverse incentivisation of procurement and consulting organisations but if these expectations are based on a, 'like for like' service experience and scope then this is clearly not sustainable.

Recent trends to generically promise or expect savings against "innovation" (IoT, big-data, AI and machine learning, etc.) need to be credible and consider appropriate levels of investment and time to yield. At this stage there are few available verified cases of objective return on investments achieved within the facilities management and services industry as a direct result of such applications.

Consideration should be given to the original reasons for outsourcing in the first generation and, "Right-sourcing" should:

- Reduce or even remove the emphasis on cost savings, potentially declaring a reasonable common savings target and then evaluating suppliers' proposals based on their technical response, credibility and non-financial benefits to core-business.
- Categorise and review savings on the basis of:
  - 'Same for Less' – i.e. same service outcome/experience for less cost
  - 'Less for Less' – i.e. reduced service and, or outcome (where this has least material impact) for less cost
  - 'More for Same' – i.e. increased service and or outcome (where this has material benefit) for no cost increase.
- Apply the 80/20 rule to any savings evaluation: the logic, methodology and timing of at least 80% of the savings must be explainable and credible.
- Use internal and external (i.e. suppliers bids) benchmarking to evaluate credibility and risk. Allow suppliers a fair reward for fair effort considering the direct and indirect benefits to the customer's core business.
- Agree reasonable return on investment targets for new technologies and appropriate tolerances around which the Supplier incurs risk and reward.
- Share responsibility for success between Customer and Supplier in relation to each other's freedom and power to transform.
- Structure consulting fees and retained organisation objectives on term results not just 'day one' of any sourcing project.
- Consider partial insourcing if the benefits to core business are not considered equitable to reasonable margin and profit levels for supplier(s).

3.2 Management, IT Systems and Innovation

One of the objectives of outsourcing is that the supplier will implement a management structure relevant to the services being their core business. This includes personnel and processes as well as automation of the associated workflow, information capture and reporting via IT solutions. The customer can then re-organise appropriately to the degree of outsourcing of management to the supplier, moving from direct to indirect management accordingly. While this is a reasonable expectation, some challenges predominate:

3.2.1 Organisation

The customer organisation as a whole and specifically the customer's contract management (retained) organisation, must understand and be ready to receive and manage the agreement and allow the supplier the freedom to act as intended. The retained organisation (and their objectives) should be designed considering the longer-term transformation objectives, as well as the challenges of initial contract implementation. One large global finance sector customer created a 'rules of conduct' charter and ran a series of education and training sessions for the benefit of both customer and supplier staff. It also worked well for me as a customer on two occasions, to implement a balanced scorecard bonus scheme for key management, that included an incentive to achieve the desired outcomes of outsourcing agreements.

3.2.2 Processes

All too often, customer sourcing projects demand significant levels of information on supplier's processes and procedures in response to requests for proposals. Supplier back-office processes and procedures may be relevant to customer objectives but focus on those aimed at service delivery for these customers, can only be generic until applied at specific customer sites and services. It should be acknowledged that customers will inevitably have local solutions in place albeit diverse and unharmonised. Better questions would be around how and when suppliers will review, identify and close any gaps in processes and procedures, as well as how suppliers will maintain training and capacity of staff to understand and follow customer-specific quality systems (e.g. Good Manufacturing Practice).

3.2.3 IT

Myriads of IT solutions associated with the scope of facilities management and services exist. Ranging from those focusing on specific assets and services, through to entire real estate management.

Customer organisations will almost certainly have local IT systems and related data history in place, that addresses the scope of the sourcing activity. While being diverse and unharmonised these should still be considered. Whatever solutions are selected, there will then be parallel and adjacent IT systems within the customer's business that will need to be addressed. Potential for the capture of (big) data has exploded with the evolution of IoT, cheap sensors, improved data transmission and mobile applications; with ever improving user interfaces and user uptake. However,

> **“structuring the information for comparison and analysis, then proving the returns on related and further investment into Artificial Intelligence and Machine Learning, remains a challenge for the industry.”**

Direct returns on investment inevitably rely predominantly on reduction in labour which may already be at relatively low cost and, or, implementation of local actuation of derived actions, which in turn will rely on labour or require investment in local hardware.

As technology continues to develop at an exponential rate, the objective of, 'innovation' has increasingly appeared in customer objectives when sourcing. This can be grouped with similar requests for benefits from IoT and Big Data. Unfortunately, definitions of expectations remain vague and subjective.

3.2.4 Service Desk / Help Centres

Provision of a means of raising, allocating, tracking, closing and reporting of reactive works, has always been and remains a requirement of Facilities Management and Services solutions. Together with greater sophistication of IT solutions and a growing acceptance of virtual interface options, available solutions have become increasingly digital and less reliant on human interfacing over the years. There often remains a requirement for a fall-back human interface in the case of emergencies and/or, situations that deviate from those that can be addressed via the virtual options. The challenge remaining for the market is how to ensure the solutions can include enough service, asset and/or site-specific intelligence and knowledge to address the out of line situations. This challenge is exacerbated where the human element is covering a wide range of services, sites and even countries (where centralised or off-shored).

3.2.5 Observations and Recommendations

Due to the immense complexity of software, hardware, architecture, scope of services and human interactions, I cannot honestly say that I would know what best practice was if I witnessed it. My experience to date, has been that large-scale ambitious projects and platforms, as well as smaller service or system specific solutions, will fail to meet expectations if required outcomes, purpose and incentives for use are not clear and anchored.

The unfortunate consequence here being that the scale and cost of failure is relative to the initial ambition. Considering all the complexities in conjunction with the rapid and exponential increase in available solutions:

> **“I believe that the best approach is an ecosystem of supplier and customer IT systems within a constantly updated technology plan (IT road map), maintained and managed by the customer.”**

Data collection and reporting parameters would be aligned where required for trending and comparison, as well as possibilities to later change outputs and integrate systems.

Summarising this section Right-sourcing would:

- Consider including ‘charters of behaviour’ in contract terms to promote right behaviours between the Parties and to support mutual contract interface management and governance.
- Acknowledge that relevant local customer processes and procedures may be adopted at startup. Allow time to discover and close any recognised gaps and only push for harmonisation where this has a benefit worth the associated effort.
- Establish a realistic and specific road map of what is expected from supplier IT systems and interfaces with your customer, as part of the sourcing process. Is an ecosystem of asset and, or, service-specific IT systems, more likely to achieve a higher degree of successful outcomes case by case, than implementation of a global integrated CAFM system?
- If a customer or third-party supplier system is already in place, should this remain and if so, what role should it serve and what interfaces will be required and when?
- Establish a clear Service/Help Desk system that provides the optimum mix of central, general and service-specific, virtual and human interface options.
- Be clear about what data is required in the short term (and if possible medium term), how it will be gathered and used.
- Allow for small-scale testing and proof of concept and return on investment for IoT/AI/Machine Learning/Big Data innovations before implementing them on a larger scale.

4.
Staff Transfer

4. Staff Transfer

Transfer of staff from customers' organisations remains common in many sourcing agreements;, either as a natural step within a first generation from historical customer self-delivery, or as a result of increased breadth and depth of scope in later generations of agreements. Historically, although the Facilities Management and Services industry is a high volume, low margin business, the concept that job security, satisfaction, opportunities and career development, would be as, or more attractive within a supplier company, where the services undertaken are considered core business was very valid. While this is still often the case, my observations conclude that commercial pressures applied to the supply-side in later generations of outsourcing, are resulting in poorer life-work balance and a negative impact on attracting talent, both from the customer side and labour market in general. This is exacerbated in some cases, by demographics.

Suppliers are expected to take on transferees' balance sheet risks (i.e. notice, severance, sickness, etc.), deal with compensation and terms and conditions differentials, provide training and development and performance management and any costs associated with restructuring to agreed commercial objectives.

At best, some of these risks may be transparent to the supplier early in the sourcing process, (especially where customer staff are identified in scope for transfer) but in many cases, especially where incumbent supplier staff are to transfer or be re-hired, (depending on local laws), relevant information is not available and related risks can only be estimated until contract signing.

I too was subject to an outsourcing process in my early days which proved as a catalyst and inspiration for my future career. During this process it was explained to me that just as for an internal workforce.

Around 20% of transferees will be high-flyers, 60% will basically perform as they did pre-transfer and 20% will need some form of performance management.

Subsequent observations over the years have generally verified this statement.

Right-sourcing should moderate commercial expectations with these requirements, risks and realities. Bearing in mind that often the majority of savings must come from reduction in labour whilst Corporate Social Responsibility and Brand Protection is an increasing focus for both Parties.

"Focus and downward pressure on rates of pay and supplier margins, should be stopped in favour of focus on the direct and indirect benefits of the sourcing solution."

5.
Baselines and Benchmarking

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At a most tactical level, sourcing activities are based on input specifications, hourly rates, etc. per service against individual assets, spaces or occupancy demands. This leaves the management of outcomes, planned and reactive running costs and life-cycle performance of assets and services, firmly with the sourcing organisation. The tendency here has been to focus on driving down unit costs and in earlier generations may have generated logistics and overhead efficiencies. However, in recent years, if adequate consideration is not given to the number and effectiveness of the combined planned and reactive units of service, or how suppliers are to find progressive efficiencies on a 'like for like' basis, then they may tend to inappropriate behaviours, in order to maintain profitability.

At the strategic (outsourcing) end of the scale, where organisations source management of costs and services of bundled services to an output/outcome specification; there is a reliance on a cost, volume and service level baseline exercise to support subsequent performance evaluation.

It is the nature of non-core business that related costs, volumes and service levels are not accurately managed. This is often further exacerbated by decentralised budgets and cost-centres, with mixtures of owned and leased buildings of differing sizes, usage, workplace design, assets, condition and populations. There is also the complication that some costs are repetitive and predictable in nature (fixed costs) whilst others are not; including overlaps between 'business as usual' scope and refurbishments, capital replacements and one-off events (variable costs). Where sourcing is to include the transfer of management and delivery scope undertaken by internal staff, related internal costs also need to be properly understood and accounted for.

All of these elements need to be discovered in order to evaluate the commercial performance of any sourcing activity, regardless of whether shared with the supplier or not. Furthermore, management and administration resources need to be allocated to track subsequent changes.

At both ends of the sourcing scale, benchmarking is a useful approach that can help evaluate opportunities but equally, risk and identify likely errors or misinterpretation. However, results are inherently inaccurate, at discrete levels and are therefore best used to validate outliers, evaluate aggregated positioning and as a basis for tracking trends.

A further challenge is that in earlier times, contract details with incumbent suppliers were shared more freely with the market during a sourcing exercise. This was mainly because most of the available solutions were management based and would therefore be most likely to work with the incumbent suppliers in some way, (at least initially). With the emergence of Integrated Facilities Services suppliers, who provide both management and services under greater self-delivery, this practice has all but stopped.

Considering all these issues, the following observations in recent years are surprising:

— Data in second and third generation-plus sourcing activities, is often still lacking, despite this being an objective of preceding generations.

— Customers often come to market with poor and hurried baseline information, in conjunction with increasingly onerous programs and contract terms, that limit joint discovery and validation, as well as creating down-stream issues between the Parties. This is especially prevalent with respect to fixed versus variable costs, opex versus capex, and associated volumes.

— Consultants and procurement functions tend to defend spurious baseline information and do not allow time for review pre-contract (including specifications and volume data), even where interpolation and cross-referencing clearly indicates gaps.

— The availability of reference benchmarking data remains scarce.

— Benchmarking and unit comparisons focus on discrete and one-off lowest costs, ignoring productivity and efficiency and/or aggregated performance and trends.

A Right-sourcing approach would embrace the following principles:

Baselining

— Allow time and resources for a robust internal review and baseline exercise before approaching the market.

— Be open and honest about what data is available when approaching the suppliers.

— Classify data as 'definite', 'indicative' or 'estimated' according to relative level of confidence.

— Use interpolation, extrapolation and benchmarking where data is missing. Classify as above accordingly and use provisional sums where data requires validation post contract.

5. Baselines and Benchmarking

— Allow for supplementary resources during mobilisation, transition and start up, to support discovery, communication and governance.

— Allow for reasonable tolerances, time and an appropriate joint process for verification.

On-going data capture and reporting

— Understand why data has not been previously captured.

— Are Computer Aided Facility Management (CAFM) Systems in place but not operationally viable?

— Are financial systems and data structures aligned to expected operational and commercial reporting structures?

— Review what data is actually required as a minimum and be realistic in expectations and the solutions to capture it; start simply and progress to next levels over time.

— Acknowledge the required management and administration required by both Parties to gather data and track performance and be wary of related costs outweighing benefits.

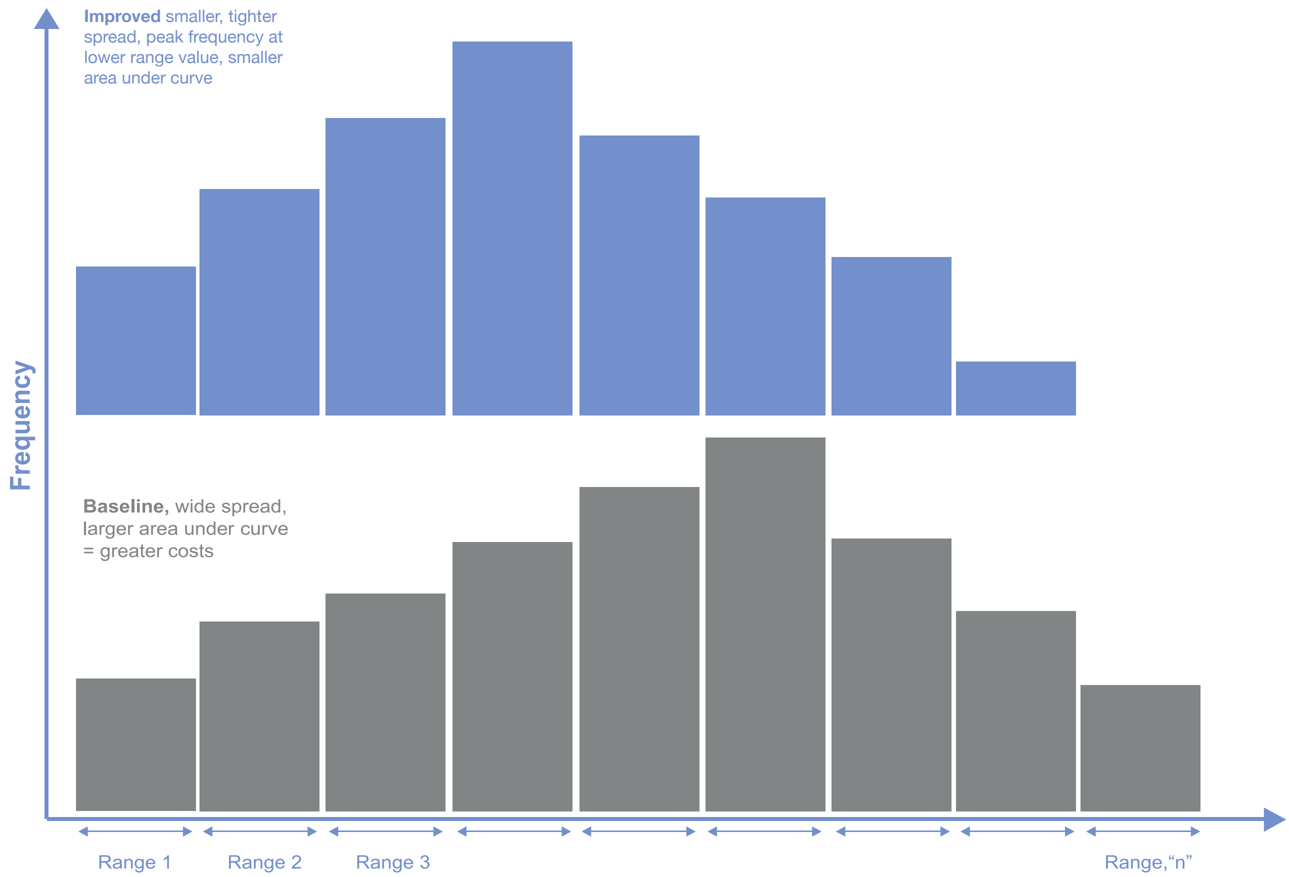
— Ensure that, post contract, suppliers have an on-going duty to 'dummy' populate a snapshot of current baseline costs and volumes on an annual basis so that your customer remains 'market test ready' for future generations of the contract.

Benchmarking

— Use as a means of continuous investigation and potential improvement of outliers.

— Use aggregated data to track trends as shown below:

Evaluating Improvements via Benchmarking



Benchmark range
(e.g. cost/m2, cost/customer, cost/m2, cost/asset, volume/customer etc.)

6.

Service Levels, KPIs, Service Credits

6. Service Levels, KPIs, Service Credits

Describing service requirements from an output (i.e. a frequency of event, measured parameter, response or resolution time, complaint levels, etc.) or outcome (impact on customers core business as a result of outputs such as brand, production capacity, employee retention, etc.) perspective has always been and remains a difficult and often subjective issue.

Various performance measurement models exist, often reflecting the maturity of the customer organisation's experience and the level of sourcing between tactical and strategic, input and single service, to outcome and bundled services. Earlier generations of sourcing reflected a point of departure from diverse, disparate and in many cases, non-existent internal performance management systems (people, processes and IT), so related measurement structures and penalties and incentives considered how things were done prior to sourcing.

"Today there remains a wide spread of service level descriptions, and related performance parameter measurements (Key Performance Indicators or KPIs), often appearing like a 'wish list' rather than reflecting historical performance."

While savings and cost targets are covered in the overall commercial agreements, the KPIs all predominantly fall under the categories of Availability, Compliance and Performance. Numbers of contract KPIs inside these categories can range from somewhere between ten and twenty items, to well over fifty.

When the latter cases are applied to multiple services, sites and geographies, the potential for conflicts due to the compounding or, dilution of measurements in the aggregate and the resulting administration, often renders these systems sub-optimal. Further complications have then arisen with the increased application of penalties (service credits), linked to these performance management systems. Penalty systems are dubious, as in my experience, no supplier will knowingly and continuously jeopardise a reasonable contract agreement and relationship. If the practices have evolved to lock suppliers into bad contracts, then this is only treating the symptom and not the disease.

At worst, the interface drives the wrong behaviour by both customer and supplier, leading to a focus on chasing or avoiding the measurements of faults and associated penalties between the parties, instead of working together to prevent and solve issues to mutually beneficial outcomes. Even in healthy measurement systems, cases of the 'watermelon effect' occur; whereby all contract scoring is green/acceptable but key stakeholders within the customer's core business are not satisfied with the perceived outcomes.

Examples I have seen include only four main categories based on Compliance, Quality, Availability and, or Satisfaction as contracted, penalty or incentive bearing Critical Performance Indicators with a maximum of three to five sub measurements.

Any further operational performance indicators are then expected to be undertaken by the supplier but subject to proactive or reactive audit.

At worst, I recall a European agreement where over seventy performance indicators were included as contract KPIs with a mix of predominantly monthly but also quarterly and annual measurement cycles. When applied over multiple sites and countries the related efforts and confusion around rules of application and aggregation created a 'cottage industry' for both Parties. Fortunately, good relationships combined with a reasonable contract, allowed a review and transformation to a far more reasonable approach within the second contract year.

One of my first agreements in the Nordics included a subjective question to all key department heads along the lines of , "do you like the supplier?". While this approach may be similar in thinking to more recent Net Promoter Score models, its beauty was in its simplicity and focus on the trends of individual scores and not the absolute aggregated results. Even as a supplier I liked the approach, which assisted both sides in key stakeholder management.

I have never seen it applied since, possibly because a less mature sourcing organisation would feel that this interface should be retained, or supplier organisations felt it was too subjective and risky when combined with too onerous associated contract terms.

6. Service Levels, KPIs, Service Credits

Right-sourcing would address all the challenges of service levels, KPIs and service credits as follows:

- Limit contract KPIs (Key Performance Indicators) to an absolute minimum.
- Allow for subjective KPI measurements for key stakeholders and consumers of the services.
- Include the expectation that suppliers will monitor Operational Performance Indicators (OPIs) - parameters that should be measured as good management practice but do not in themselves carry risk or incentives. These would be mutually reviewed and adjusted, in the event of any KPI failure and that evidence (by audit), that these OPIs are being measured by the supplier, is itself a KPI within the Compliance category.
- Limit KPI measurements to a long as possible measurement cycles but expect the supplier to track and report supporting OPIs on a regular (monthly) basis.
- Allow for adequate baselining pre and post-contract commencement, including supplier wherever relevant.
- Consider the use of trends as opposed to absolute measurements where relevant (e.g. where no historical baseline exists or they are very different, and/or where measurements are subjective).
- Set reasonable targets with minimum thresholds, that reflect historical and expected performance, considering the mutually agreed savings and transformation goals in the overall commercial agreement.
- Abolish penalties in favour of incentives but protect the customer against critical and material one-off or chronic poor performance by supplier(s), through the mechanisms of the main contract agreement (e.g. insurances, warranties, rights of remedial action and partial or whole termination).

7.
Cash Flow

7. Cash Flow

Payment terms offered by customers have also progressively deteriorated from between 30 to 45 days, through to 60 to 90 days and recently 120 days.

Factoring and Supply Chain Financing options have arisen to help alleviate the negative impact this practice has on the market but these still push cost and risks to the supplier and deteriorate the supplier's overall financial health.

Customer organisations should consider the social-economic impact and influence that their practices around payment terms have.

"Right-sourcing with less than 60 days payment terms should be included as part of Corporate Social Responsibility considerations."

8.

Contract Commercial Models and Customer Readiness

8. Contract Commercial Models and Customer Readiness

Many forms of contract commercial models now exist, ranging from fixed-price and unit-rates, to Guaranteed Maximum Price (GMP) through to collaborative and Vested* type agreements with many variations in between.

> **The degree of management responsibility being passed to the supplier, the accuracy of the available historical commercial and operational information and the stability of demand and supply requirements, all determine which model is appropriate.**

Of equal importance, is how ready is the customer organisation to receive and manage each model?

A customer with a large, retained organisation, that internally manages specifications and fixed price/unit-rate based suppliers to meet the demands of the core business and which is familiar with this structure (and is probably reflected in their culture), is highly unlikely to have success in outsourcing this management function, together with the services delivery, straight into a collaborative/ Vested arrangement.

Various approaches can work well. Provided a thorough specification is developed for a fixed price model, or a well derived and rational financial baseline is developed for a GMP-type model. Coupled with with sufficient volume information and/or estimations or benchmarks where there are gaps in either.

I have had good experience with a global contract which was predominantly a first generation outsourcing for an IT sector company. Although the specification was based on an output specification; sites, volumes and expectations were very well described and related cost targets were rational when cross-referenced and benchmarked. Issues related to the incumbent service providers and transferring personnel, were then disclosed and thrashed out post down-selection.

GMP processes, where financial baselines could be interpolated against building and volumes information and 'common sense' applied, in an open-minded way by Customer and Consultants to resolve any obvious gaps, have also in my experience worked well.

However, I have also had experience of the opposite. Especially in relation to GMP agreements in recent years, where either baselines and/or services, volumes descriptions and inclusions of variable works (especially within repairs and maintenance), have had obvious gaps when the data is cross-referenced within itself for comparison let alone to external precedents.

Customer and consultant organisations have pushed suppliers into 'baseline-less' agreements on such questionable data and suppliers hungry for growth have sadly accepted. This intent to pass over and take on unknown, or undisclosed risks by customers and suppliers, has led to many bad deals for one or all Parties. It Will damage the industry if continued.

8. Contract Commercial Models and Customer Readiness

Finally, the recent COVID-19 situation gave rise to much debate as to whether or not force majeure was applicable between customers and suppliers. This has been further clouded by government furlough schemes providing support and therefore making clear cost impacts difficult to derive. Requirements to shut down services and buildings were communicated in haste and sometimes with little consideration of the required degree of shut down, implications to maintenance, security and compliance (duty of care) or the expected capability to reinstate normal operations.

Examples of best practices were, where the Parties managed to categorise and agree various levels of reduction in building usage and re-allocate costs and labour to bring forward periodical services, refurbishments and projects, etc. Using support schemes to maintain readiness and minimise impact on unutilised staff. In many cases, customers continued payments at or near pre-COVID-19 levels as a measure of solidarity and to promote CSR which is to be admired.

A Right-sourcing approach should embrace the following:

- A possibly self-evident observation that often seems forgotten in sourcing processes, is that the most successful contracts are those based on reasonable objectives, equitable mutual benefits, reciprocal terms and rights for each Party and respect for the individuals involved.
- Do not underestimate the benefits of applying adequate resources and taking time to discover and describe current management, services, demand profiles, volumes and cost baselines, to anchor sourcing objectives with stakeholders and prepare the internal organisation before approaching suppliers.
- Allow open discussion around any perceived gaps during the sourcing activity and consider the recommendations included in the preceding Baselines and Benchmarking section.(5)
- Consider lessons learnt from COVID-19. Indications are that something similar will happen again in the future. Therefore, prepare and describe for various levels of building shut down, along with commercial agreement around notice, reinstatement and compensation (with or without the presence of government support).

*Vested is a methodology developed by the University of Tennessee whereby the customer and supplier align via a collaborative process to better realise desired outsourcing outcomes for both Parties.

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Terry has been an Engineering and Facilities Management professional for thirty years.

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He relocated to Sweden in the late 1990s, where he was North European Director at Johnson Controls for 7 years, before moving to Nordea to take up the position of Head of Full Sourcing – covering large scale projects for both regional and off-shore agreements.

Since the mid-2000s Terry has enjoyed a long career with ISS leading up to his most recent role as Group Vice President, Head of Enterprise Development Corporate Clients (Global). He has driven business development, leading on bids and negotiation. Terry has also worked on prioritising transition, transformation and product development for regional and global clients.

Terry is solution-oriented and secures and drives change and development based on a combination of personal and technical skills and experience within Facilities Management, Engineering and Business Processes.

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