

## Appendix A - Insourcing vs Outsourcing Options Appraisal

### 1.0 Executive Summary

Slough Borough Council faces significant budgetary pressures across the next few years and as a result need to continue reviewing their service provision options as they look to make efficiencies, reduce budgets and improve performance. While some authorities see the best way of achieving these measures is through handing as much as possible over to external contractors (outsourcing), others believe bringing services back in-house (insourcing) is the more cost-effective long term option.

The Council has outsourced its Environmental and Highways Services and following a reallocation on the prioritisation of the outcomes of what services are expected to delivery the Council have to appraise whether or not they continue with decision to outsource services made at Cabinet on the 16<sup>th</sup> March or bring these services in house. This options appraisal paper does not look at other potential options for delivering the service other than by delivering them in house or contracting them out (outsourcing). Appendix B looks at two options for insourcing the services.

It was considered that the most appropriate way forward was to undertake a high level review using the knowledge, experience and intuition of staff to identify the key risks associated with insourcing vs retaining an outsourced service.

The review criteria considered when appraising whether the waste management service should be kept in house or outsourced were:

- **Costs:** The service needs to provide value for money;
- **Quality:** The service needs to perform the service efficiently and meet the requirements of the Council;
- **Operations:** The service needs to be deliverable;
- **Capacity:** The service will require experience and skills of staff to prepare, manage and deliver an in house service;
- **Commercial services:** The ability to provide income for the Council and for the Council to provide commercial services to the market.

The review highlights a number of issues the Council need to take into account. It highlighted both negatives and positives from both methods to deliver the services. The reviewers investigated these issues to identify the risks of both methods of service delivery and identified that there are more risks from insourcing in this instance than outsourcing.

The key risks identified with insourcing include:

- Lack of operational experience of management team;
- Limited contingency arrangements;
- Central resources (HR, Finance and management) required to cope with a major influx of staff at contract start;
- A skills gap which is likely to result in cost and time implications for staff training and mentoring;
- The need for robust barriers between the in-house bid and procurement teams if services are brought in-house via a procurement process.

The key risks identified in keeping the contract outsourced are:

- The availability of only a headline cost comparison and not any detailed cost analysis;
- Cost implications of a lack of flexibility in a contract and absence of competition in the market;
- Lack of political support for outsourced provision;
- Reduced ability to be reactive to political and residential needs;
- Outsourcing of risk, skills and services means paying and acknowledging that public funds are used to provide a dedicated profit margin to the private sector

## 2.0 Risks

The risks identified in insourcing and outsourcing are outlined in more detail in Tables 1.1 and 1.2 below.

**Table 1.1: Insourcing Risks**

Risk	Expansion
Experience	<p>Lack of operational experience of management - the current Public Realm, Environment, Highways and Transport services, apart from Highways, are presently operated with a thin client model. This means that there are only two officers on the Council side with in depth service knowledge (one Waste and the other Grounds/street cleansing). Supervisory support is provided by the incumbent (Amey). As a result this current lack of depth and experience the Council will (dependent on the outcome of any TUPE transfer) need new staff and a larger number of officers. The future internal client / contractor split will need to be reviewed too.</p> <p>This will also impact upon the ancillary services such as finance and HR to deal with significantly increased number of staff (all operatives would become council employees).</p>
Contingency	<p>Limited contingency arrangements – what mitigations / contingencies (in respect of resources that can support the mobilisation) can the Council introduce at the point of transfer to guarantee service delivery?</p> <p>The Council will have minimal supplier relationships for key assets: vehicle suppliers; vehicle hire companies; agency staff suppliers; etc.</p>
Contract	<p>The Council will have to ensure that any staff involved in any in-house bid (as part of a procurement process) are distinctly separate from those involved in the procurement itself. This will require additional staff resources</p>
Mobilisation	<p>Ability to adapt to a changing environmental and political agenda.</p> <p>Changes in law unless specified in a contract can result in expensive service amendments, by delivering the service in house these maybe reduced.</p> <p>A challenge in bringing the service back in-house is that when the contractor moves on they take their specialist skills and best staff with them. This can lead to major gaps in skills and capacity.</p> <p>Similarly, the in-house team may have little or no knowledge of contract mobilisation. This is an intense, multi-disciplinary process over an average six month period. The Council will need to be confident that they have the staff and skills to project manage a significant transfer of staff.</p> <p>Typically local authorities have experience of the TUPE transferring of staff 'out' or between outgoing and incoming service providers. Experience of TUPE transferring staff back in-house is less common.</p> <p>There is also the issue of the central resources (HR, Finance, H&amp;S and management) required to cope with a major influx of staff at contract start especially if central support costs and resources are not increase proportionally to accommodate.</p>
Skills	<p>Bringing the service back in house may identify a skills gap and result in cost and time implications for Staff training and mentoring.</p> <p>The present staff are unlikely to have operational experience on issues such as working practices, including routes or schedules, for the provision of waste management and other services.</p> <p>There is also the issue of the central resources (HR, Finance, H&amp;S and management) required to cope with a major influx of staff at contract start especially if central support costs and resources are not increase proportionally to accommodate.</p>
Infrastructure	<p>The Council has outsourced the contract for 15 years and have little capacity to manage the influx of a number of operatives , obtain necessary vehicles, mechanical plant (machinery) and equipment</p>
Lack of benchmarked cost against outsource costing	<p>The key risk identified in insourcing the service is that the Council will not be able to prepare a market tested procurement and thus arrive at a benchmark service cost from the private sector. The only figure that can be used as a comparator, when composing the cost to insource the service, will be the present service cost.</p>

**Table 1.2: Outsourcing Risks**

Outsourcing Risk	Expansion
Benchmarking of Cost	No accurate cost of a Council delivered service to benchmark against a contractor.
Lack of flexibility	Contracts are by nature complex and legally binding and often carry premium 'penalties' should a Council wish to change the way in which a service is delivered. Depending on the sophistication and 'forward looking' capacity (i.e. does it allow for service options) of the pricing document, there may be fixed pricing arrangements which bind the Council client into either set minimal financial arrangements or expensive contract variation clauses
Lack of political support for outsourced provision;	When the previous assessment was undertaken in February 2016 the inverse was correct. There was no political support for insourcing but now there is a significant political preference for an insourced service. Therefore, an outsourced service would not receive as much political support or commitment.
Reduced ability to be reactive to Council needs	An outsourced contract is not as flexible as it is not under direct control of the Council. Therefore, it cannot be as reactive to immediate and short terms priorities of the Council.
Outsourcing of risk, skills and services means paying and acknowledging that public funds are used to provide a dedicated profit margin to the private sector	At a time when Councils need to be more commercially astute the outsourcing of all functions to manage and mitigate risk, skills, staff, assets and services inherently includes a dedicated margin of profit from the private sector for the provision of this service. This margin could be yielded as an efficiency by the Council if the Council were able to provide the service at a similar level of cost. From a political and public funds perspective the provision of public money to supplement private sector profit margins is a risk in terms of the perception and buy in into provision of an outsourced service.
Lack of benchmarked cost against inhouse costing	The key risk identified in keeping the contract outsourced is that the Council will not be able to prepare a ghost bid and thus arrive at a benchmark service cost. The only figure that can be used as a comparator, when evaluation any tender price, will be the present service cost.

In summary given the current risk identified and the findings of the review criteria considered from the appraisal Slough Borough Council is currently in a position to make either an in-house bid to deliver these services for the 2017 Environmental Services contract or to outsource these services. The risks identified above and the programme of work that would be needed in order to mitigate these risks can be prepared depending on either route.

### 3.0 Finance

The financial implications of Environmental Services are exceptionally significant and have a combined total value of over £12 million to the Council (excluding additional works).

A headline financial appraisal has been undertaken regarding the financial differentials between 'insourcing or outsourcing' the service in Appendix A. In summary, it is understood that services can be provided at a lower cost than current provision from Amey although the Council has greater flexibility to dictate the extent of savings from a competitively procured outsourced contract.

The analysis shows that using the in-house Single Status Workforce that a private sector operator would result in a c. 19% saving whilst in-sourcing with a single status workforce would result in a c. 16% saving. However, migrating to an in-sourced two tier workforce would result in savings of approximately 22%. Any savings resulting from insourced provision will not match the 30% savings that would be requested from the market from a competitively procured outsourced contract to meet the Five Year Plan savings targets. However, an insourced contract provides greater flexibility for the provision of income generating services although these are limited by the respective insourced vehicle.

The Amey profit margin over the entire contract was 12% in 2015 and it is to be noted that vehicle costs will be a key cost driver in any proposed insourced provision to further reduce cost.

Refuse and Recycling accounts for 22% of the total operational expenditure under the Amey contract (£2,802,443 of a total £12,606,833). The Amey profit margin over the entire contract was 12% in 2015. This is significantly less than the margin calculated for refuse and recycling below as 26.3%.

**It is likely that Amey are targeting a margin across the entire contract and so the margins and potential savings below just for waste collection are highly unlikely to be representative of the savings that can be made across all services.**

Current Collection system	Ghost Bid Options			Amey
Options Matrix	Option 1 Private Sector	Option 2 In-house Two-Tier workforce	Option 3 In-house Single Status Workforce	2015 Refuse and Recycling Management Accounts
Front line vehicle costs Inc. insurance, fuel etc. <b>Fleet sub total</b>	£1,140,408 <b>£1,140,408</b>	£1,201,115 <b>£1,201,115</b>	£1,201,115 <b>£1,201,115</b>	£953,850 <b>£953,850</b>
Front line operative costs <b>Wages sub total</b>	£1,349,065 <b>£1,349,065</b>	£1,349,065 <b>£1,349,065</b>	£1,543,457 <b>£1,543,457</b>	£1,783,584 <b>£1,783,584</b>
<b>Other Operational Expenditure</b>	-	-	-	<b>£64,999</b>
<b>Gross Operational Expenditure</b>	<b>£2,489,473</b>	<b>£2,550,180</b>	<b>£2,744,572</b>	<b>£2,802,433</b>
Operational overheads	£254,555	£248,955	£259,355	-
Management Salary costs	£154,009	£154,009	£176,026	-
Central Support Costs	£166,000	£158,600	£158,600	-
Office Costs	-	-	-	£35,240
Management Charge @ 3%	-	-	-	£107,407
IT/Audit/Insurance	-	-	-	£82,995
<b>Gross Overheads</b>	<b>£574,564</b>	<b>£561,564</b>	<b>£593,981</b>	<b>£225,642</b>
<b>Total Gross Expenditure</b>	<b>£3,064,037</b>	<b>£3,111,744</b>	<b>£3,338,553</b>	<b>£3,028,075</b>
<b>Profit/Contingency</b>	<b>£266,000</b>	<b>£96,000</b>	<b>£103,000</b>	<b>£1,081,327</b>
<b>Net Cost to SBC</b>	<b>£3,330,037</b>	<b>£3,207,744</b>	<b>£3,441,553</b>	<b>£4,109,403</b>
<b>Profit Margin</b>	<b>8.0%</b>	<b>3.0%</b>	<b>3.0%</b>	<b>26.3%</b>
<b>Gross saving versus Amey 2015 Management Accounts per annum</b>	£779,366	£901,659	£667,850	
<b>% saving versus Amey 2015 Management Accounts per annum</b>	<b>19.0%</b>	<b>21.9%</b>	<b>16.3%</b>	

Full year data for 2015 from the Amey Management Accounts for Slough Enterprise Ltd have been used to align the data to the year in which the Ricardo Ghost Bid analysis was produced (1 November 2015). No adjustments for inflation have been made.

The analysis shows that using the in-house Single Status Workforce that a private sector operator would result in a c. 19% saving whilst in-sourcing with a single status workforce would result in a c. 16% saving. However, migrating to an in-sourced two tier workforce would result in savings of approximately 22%. Any savings resulting from insourced provision will not match the 30% savings that would be requested from the market from a competitively procured outsourced contract to meet the Five Year Plan savings targets.

The "Net Cost to SBC" from the Amey Management Accounts for Refuse and Recycling does not reconcile to the Total Revenue figure for the service due to the allocation of additional overheads and the removal of the Profit Share figure (which is assumed to be a deduction from the total amount paid from SBC to Amey).

Therefore, the private sector could be specified to yield a saving of 28 - 30% against the total budget whereas an In-house service could yield a 16 - 22% saving against the total budget depending on workforce

type. Current estimates of savings are expected to be around £1,500,000 - £1,800,000 per full financial year as part of the transformation if the service were to come in-house.

However, frontloaded savings if the services were fully outsourced would be considered to be around 28 – 30% of the current budget equating to approximately £2,370,000 – £2,540,000 as this would be stated categorically within the specification for tender.

The balance is between the ability to make frontloaded savings of 28 – 30% of the budget through outsourcing against the ability to make frontloaded savings

Scenario	Insourcing	Outsourcing
Overarching Savings (£)	£3,200,000	£2,370,000 – £2,540,000
Increased Overheads (£)	£1,200,000 – £1,700,000	
Net Savings (£)	£1,500,000 - £2,000,000	£2,370,000 – £2,540,000
Percentage of Fixed Budget Equivalent (%)	17.7 – 23.6%	28 – 30%
Overheads as 'one off cost'	£100,000	-
Overheads which can be reduced through 'Business Planning'	£500,000	-
Maximum Savings	£2,100,000 - £2,600,000	£2,370,000 – £2,540,000
Percentage of Fixed Budget Equivalent (%)	24.8 – 30.7%	28 – 30%
Income Generation	YES	NO
Profit Share	NO	YES
Dependent on workforce structure	YES	NO

#### Increased overheads breakdown from Insourcing:

**Pension Costs Additional £300k to £800k cost:** Wages are approximately £5.6m with includes £300k of pension costs, if all staff go into a Final Salary Scheme then the cost if 20% contribution would be £1.12m so worse case an additional £800k. Highly unlikely all staff would join the scheme hence a range of £300k to £800k.

**Increased local overhead – additional 200k cost:** The contract currently benefits from private sector divisional and group resources in HR, HSQE, Finance, Legal, Commercial including procurement. There will be a need to increase Central Support Costs (CSC).

**Purchasing power – additional £100k cost:** The private sector is able to leverage economies of scale over materials, PPE, fuel etc. SBC might be able to achieve similar by forming a Local Authority Buying Club with neighbouring authorities running in-sourced provision.

**Legislative compliance/audit and employee training £100k:** SBC would have increased liabilities which would need to be demonstrably managed, notably Fleet Compliance, Waste Permit Compliance and Health & Safety liability. Each requires development of a bespoke quality system to be audited by external bodies Fleet by the Fleet Transport Association, HS by The British Safety Council, Waste Permit by Environment Agency. There would need to be periodic systems audits by these external verifiers to ensure that the Council is able to demonstrate that it is fully compliant with all staff appropriately trained

**Control of labour costs £500k:** There is a risk that a Local Authority may not be as robust in controlling labour costs, particularly sick pay, as a commercial organisation. Therefore the Council will place a contingency number against this of 10% of wages.

**Client Team Costs £125k:** The increased management of risk, sub-contractors and services means that one additional member of staff client and contract management team personnel will be required and revised job descriptions.

Overall the frontloaded savings from running an outsourced provision are immediate and cashable through a procurement process. The savings of an in-house service are partially immediate but can be elevated to equate to outsourced provision through a dedicated commercial business plan to remove excess overheads

from insourced provision and also to pursue the ability to generate income from selling of commercial services.

#### 4.0 Clienting Function

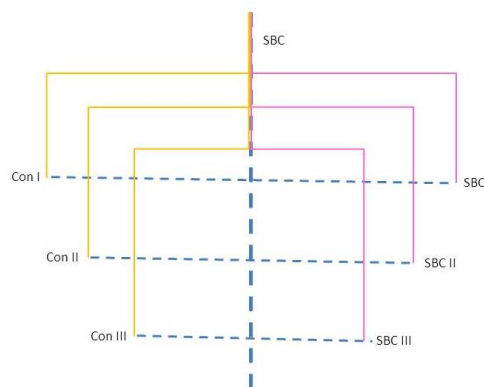
The Council will need to consider, where it does either outsource or insource the services, the future role it should utilise as a Client. This discussion lends itself to a wider consideration as to whether or not the Council pursues contracts management often described as a either 'Thick or Thin' approach.

- A **thick client** model means that the local authority will retain a lot of responsibilities (and staff) for the service and monitoring performance. For example, it can include communications, marketing, invoicing, customer services and a contract monitoring team.
- A **thin client** model essentially means just a contract manager on the client side, with no officers. This means you will need a self-monitoring contract whereby responsibilities are devolved to the service provider.

Based on member feedback received from members briefing sessions it is evident that the members would like a greater degree of operational detail presented to them, which feed into strategic outcomes and ongoing ability to utilise penalty / financial clauses in case of non-performance. This would lend itself more closely towards a 'thick client' style.

Irrespective of the composition of an in-house service or a second generation out-source contract the Council will make provision to ensure that there is a 'client oversight' model put in place. This will effectively ensure that the client oversees how operational vehicle is delivered by the contractor for each service area to ensure they are fully versed in what is being delivered to provide maximum transparency and accountability of service provision.

**Fig 1.1 – Proposed Outsource and Insource oversight model**



The clienting team will retain all strategic, financial, compliance and aggregation of all performance related either an insourced or outsourced service and will ensure maximised political and administrative governance arrangements are in place to reinforce transparency and accountability of service delivery.

#### 5.0 Summary

Priority	Insourcing	Outsourcing
Managing Risk	Red / Amber	Green
Ability to make savings	Green / Amber	Green / Amber
Ability to generate income	Green	Red
Client Management	Green / Amber	Green / Amber
Quality / Operations	Green	Green

Based on the information above correlated from a previous Insourcing vs Outsourcing Report by an independent consultant, a additional financial appraisal undertaken by an independent financial consultant and all of the information composed from the Waste & Environment team Cabinet must decide either to confirm its decision made on 14 March 2016 to commence procurement of a contract for the external delivery of Environmental Services or to instruct officers to commence arrangements for the delivery of Environmental Services and Highways in- house.