VIEWPOINT ARTICLE

Managing Risk in FM Outsourcing

AGILEOAK

TABLE OF CONTENTS

INTRODUCTION

Integrated Facility Management is becoming a common strategy for organizations with larger, complex facilities portfolios. Many Clients are concerned about the risks associated with giving broad accountability for Facility Operations to a third party Service Provider. This article discussed how these risks can be mitigated by ensuring appropriate measures are taken through each phase of the outsourcing process.

Outsourcing refers to using one or more Service Providers to deliver a broader scope of Facility Management services. The number of Vendors under contract to one Client for facilities services in an out-tasked environment can range from a few dozen to more than one thousand. Out-tasking inefficiencies can include:

- Excessively high Vendor labor rates
- Call-out charges for labor
- Minimal vendor accountability for asset performance
- Improper invoicing and billing practices
- High management overhead (managing work, vendor relationships, contracts, invoices)
- Unfavorable contacting terms

These issues represent some of the reasons why facility organizations are consolidating the delivery of their facility services under the care of a single or small group of Service Providers. This "Integrated Facility Management" solution can create cost-saving efficiencies and transfer broader performance accountabilities to Service Providers. It may also introduce unique risks when it comes to operations, service delivery and finances. The correct management of these risks does not have to be any more difficult than the risks associated with self-managed service delivery.

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Understanding Outsourcing, Understanding Risk

The Integrated Facility Management Value Proposition

Integrated Facility Management presents the following opportunities for value:

- Cost reduction and certainty
- Increased strategic focus
- Better access to Facility Management technology and best practices
- Improved workforce training and management
- Data-driven performance benchmarks
- Increased operational flexibility
- Transfer of some financial and operational risks to Service Providers.

Clients often express valid concerns about cost overruns, underperformance of service and the potential loss of organizational knowledge. The perceived loss of direct control can actually cause a Client to feel that they are exposed to greater risk than may actually be the case. Outsourced service delivery is not risk free, but rather presents a different – not necessarily greater - risk profile when compared to a self-managed service delivery solution.

Integrated Facility Management Outsourcing Risks Explored

The following risks are typically associated with Integrated Facility Management outsourcing:

- Critical service or asset failures
- Service Provider underperformance
- Financial underperformance
- Cultural rejection
- Loss of knowledge
- Labor risk

All of these identified risks can have a pervasive negative impact on operations.

"The perceived loss of direct control can actually cause a Client to feel that they are exposed to greater risk than may actually be the case."

Risk Management Overview

The most effective method of dealing with the risks associated with outsourcing is for the Client to understand and manage risks through each phase of an outsourcing initiative:

1. Preparing for outsourcing
2. Service Provider Selection
3. Structuring the outsourcing deal
4. Deal negotiation
5. Transition
6. Service Provider Governance

1. PREPARING FOR OUTSOURCING

Organizations which do not prepare adequately for outsourcing often discover that they did not accurately convey the true cost or scope of delivered services, have correct service level information or have adequate support from their senior leadership teams. This can cause serious problems, including:

- Cost over-runs
- Errors in service delivery
- Implementation delays
- Resistance from facility users

The preparation phase of Facility Management outsourcing is the period during which the Client's mandate to outsource services is established, baseline information gathered, and the business case established. A clear definition of Client outsourcing goals is crucial. The priorities and objectives determined at the beginning serve as a guide to building a solid service contract.

Understanding Current Client Operations

The first step towards establishing these goals is to obtain a good picture of current operations. This includes developing and documenting a baseline from the financial, performance and service level perspectives in order to measure possible gains in efficiency as well as cost savings from outsourcing. This makes it easier to effectively communicate service level and budget expectations to a Service Provider.

Critical systems and services must be clearly identified, required operating procedures documented and critical service levels established.

Creating Ownership in the Client Organization

Once clarified, outsourcing objectives must be understood across the entire Client organization. Supporting business units and internal business customers should be consulted for their input regarding the proposed changes. Enrolling the support of key personnel is essential. Finally, it is also important that the Client's senior management maintain ownership of the outsourcing right from the beginning.

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2. SERVICE PROVIDER SELECTION

Key to outsourcing success is the identification of the best fit Service Provider. The risks of working with the wrong Service Provider include:

- Slow implementation or mobilization of services
- Delays in the deployment of expected processes and technologies
- Disruptions with employees or third party vendors
- Service delivery failures

While Agile OAK recommends strong contracting structures, strong contracts cannot compensate for gaps in Service Provider capabilities.

During the selection phase, efforts are focused in two areas:

- Assessing the Service Provider's organization and capabilities
- Evaluating the Service Provider's proposed service delivery solution

A careful understanding of each of these two points is an important part of Service Provider selection.

Understanding the Service Provider

There are a number of factors that ought to be considered in the evaluation:

- **Geographical Footprint:** Can the Service Provider effectively deliver services in the required regions?
- **Proven processes:** Does the Service Provider have the competence, knowledge and to transform Client operations?
- **Personnel:** Will the Client be workforce be capable and well motivated
- **Technology:** What are the Service Provider's specific technological capabilities?
- **Partnering and cultural fit:** Will the service provider be able to build a successful partnership with the Client?
- **Third party vendor relationships:** Does the Service Provider have existing relationships with the local third party vendors who will be delivering services?

"While Agile OAK recommends strong contracting structures, strong contracts cannot compensate for gaps in Service Provider capabilities."

- **Business stability:** Is there confidence that the Service Provider will be financially stable over the life of the agreement?
- **Relevant Experience:** Does the Service Provider have industry experience with accounts of similar size and complexity?

Evaluating the Proposed Service Delivery Solution

If a Service Provider has shown that they have the ability to deliver the required services we must consider whether their proposed service delivery is the best fit. A good Request for Proposal needs to solicit:

- A detailed, itemized, financial bid, put in a consistent template used by all Service Providers
- Requests for "data" about the Service Provider's solution and capabilities (for example, when asking about the Service Provider's technology solution, asking how many locations the Service Provider has deployed the same technology solution)
- Details about how the Service Provider's proposed staffing, processes and technology
- The details of the implementation plan, all activities and milestones identified

Pricing should be based on Service Provider acceptance of the Client's contractual terms and conditions.

Modularity

A modular proposal requires the Service Provider to describe and cost each element of service delivery independently (for example: Cleaning, Maintenance, Office Moves...). To ensure this, the Client must assemble a modular proposal which addresses each aspect of the Scope of Work on a one-to-one basis. This helps to ensure that both parties clearly understand the resources associated with each aspect of the proposed solution and enables a more comprehensive comparison of proposals from different Service Providers.

"Pricing should be based on Service Provider acceptance of the Client's contractual terms and conditions."

Enabling the Best Proposal

It is important that both parties take ownership for creation of a successful solution. Detailed discussion followed by Client feedback on a draft proposal can help ensure that the final proposal represents the best possible option.

Evaluation considerations include:

- How does the total proposed cost of service delivery compare with industry benchmarks and other client experiences?
- Does the Service Provider's proposed solution include detailed descriptions of the roles and responsibilities of the service delivery team?
- Has the Client ensured that the Statement of Work has been understood and considered by the Service Provider?

While the Client should contractually obligate the Service Provider to keep strong financial and performance commitments, it is far better to start with a well verified service delivery solution.

"It is important that both parties take ownership for creation of a successful solution."

3. STRUCTURING THE OUTSOURCING DEAL

Having an inadequate contract in place can expose the Service Provider to significant risks including, but not limited to:

- Significant cost over-runs
- Loss of critical data
- Exposure to liability resulting from Service Provider non-compliance with regulatory requirements and company policies
- Threat of early deal termination (or imposed renegotiation) by the Service Provider
- Full exposure to the risks of operational failures
- Exposure to the risk of company intellectual property
- Exposure to the risk of loss of key personnel required to deliver services

Outsourcing Facility Management is inherently riskier for the Client than the Service Provider. A well-designed contract will appropriately balance the risks and rewards inherent to this type of relationship. We will address some of the key contractual points in this article. A more comprehensive review of these issues is discussed in the Agile OAK whitepaper “Facility Management Outsourcing: Negotiating the Business Model”.

Budget Risk

A serious concern for both parties is cost overruns. Both the Client and the Service Provider must agree on how to deal with this possibility before it happens. This means contractually ensuring that the Service Provider is assigned primarily responsibility for bearing this risk, perhaps with some limited exceptions.

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Requiring regular financial reporting can help to identify budget issues in time to correct them. There must also be a well-defined and contractually outlined payment dispute process. A ‘Dragnet’ contract clause can prevent the Service Provider from charging for ‘out of scope’ items that were intended as part of the Scope of Work.

Pricing Structure

The pricing structure must align the Service Provider's profit with the Clients success. Through many Facility Management deals are structured as "Pass-through" (meaning the costs are passed from the Service Provider to the Client without mark-up) with Guaranteed Maximum Price Provisions. The Service Provider profits through a fixed management fee, thus reducing the incentive to increase costs. Additional fees may be earned as a reward for delivering services for less than the agreed upon budget and for superior measured, Service Delivery Performance

For more detailed information about deal pricing and incentive pricing models, please reference Agile OAK whitepaper "Facilities Outsourcing: Negotiating the Business Model".

Service Provider Employees

In most Integrated Facility Management deals the majority of Client employees are transitioned to the Service Provider. Their knowledge and experience may be critical to the initial success of the outsourcing initiative. However, there is also a risk that these employees will not adapt to the Services Provider's new organizational structures and work methods.

The Client should require that certain key individuals, transitioned from the Client to the Service Provider be kept involved with their account for a specific period of time, and retain the right to verify the suitability of those personnel hired for key positions. The Client must also be able to remove underperforming personnel from the service delivery team.

Contract Termination

"Contract termination represents a significant business continuity risk to Clients."

Contract termination represents a significant business continuity risk to Clients. Clients endure most of the risks associated with the early termination of a contract, as operations could be seriously disrupted. To mitigate this, Service Providers should have strong post-termination obligations to ensure operationally continuity. In most cases, the only right a Service Provider would have to terminate a contract early would be Client non-payment of undisputed fees.

4. DEAL NEGOTIATION

An ineffective deal negotiation process can result in:

- Delays in contract execution, and thus the outsourcing process itself
- Damaged relationships between the Client and the Service Provider
- Above market pricing
- A deal structure which is inconsistent with the Client's business goals

Negotiations should be based upon a clear agenda which addresses a Service Provider's detailed review of the Client's contractual terms and conditions. By limiting negotiating to these areas, both parties can focus on working through a tightly focused negotiating agenda.

Clients must sometimes determine whether it is more expedient to have single negotiations, or parallel negotiations with more than one Service Provider. Parallel negotiations are quicker than single party negotiations because the Service Providers have more incentive to make concessions to win the business.

It is also important that those negotiating have a clear understanding of their role. This helps both the Client and the Service Provider to speak to each other with one voice. Keeping senior management fully apprised of progress can prevent any hesitation or refusal to execute the contract at the conclusion of negotiations.

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5. TRANSITION

Transition refers to the activities required to mobilize the delivery of resources to an account. This is the busiest and most complex part of the entire process. Management of transition activities can determine the overall success of the outsourcing relationship and sets the tone of the business relationship. An ineffective transition results in:

- Expected benefits not realized
- Technology and process improvements deferred or incompletely implemented
- Operational failures and customer dissatisfaction
- A negative precedent for on-going relationship management

Transition should be supported by a detailed implementation plan with the responsibilities of the Client and the Service Provider each clearly described. Major milestones should be identified (for example staff hired, technology implemented, work processes documented)

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6. SERVICE PROVIDER GOVERNANCE

Once the deal is negotiated and the Service Provider is on-site delivering services, the Client's Facility Management team must adapt to the responsibilities of Service Provider Governance. Governance is the processes by which the Service Provider will be managed to ensure effective service delivery, consistent with the goals of the outsourcing initiatives. The risks of ineffective governance include:

- Both Service Provider and Client not living up to their contractual obligations
- Deterioration in quality of service delivery, service delivery problems not resolved
- Cost escalations
- Facility customer dissatisfaction
- Expected performance improvements not implemented, commitments not honored

Role Definition

Maintaining a good relationship between Client and Service Provider requires a clear definition of each management team's role. The Client's management team must give oversight, but avoid assuming the Service Provider's management responsibilities. This would hamper the Service Provider's team and reduce their effectiveness.

When the rights and obligations outlined in the contract are not well understood or followed there is a high risk that the parties will under-perform. Contractual discipline is characteristic of most well run Integrated Facility Management business partnerships. It is important both parties ensure that their deal teams are able to train their respective colleagues on their contractual obligations.

"Maintaining a good relationship between Client and Service Provider requires a clear definition of each management team's role."

Dispute Resolution

Disputes can arise from underperformance by the Service Provider or differing interpretations of the contract's obligations and responsibilities. Having Key Performance Indicators puts both sides into a position to evaluate issues based on measured performance rather than undefined 'feelings'. A good contract contains detailed expectations regarding service delivery, as well as codified dispute resolution and escalation processes.

Growth and Change

Business and financial objectives can evolve over time. Facility Management outsourcing deals typically have a term of three (3) to five (5) years. During this period, a number of changes can occur in both the economy as well as within the Client and Service Provider companies. No contract can predict every possible business scenario. On-going discussions with the Service Provider is required to ensure that the contracted service level can evolve to meet changing client needs.

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CONCLUSION

There are proven risk management strategies that can help ensure the success of the Integrated Facility Management solution. These include:

☐	Prepare well before going to the market. Establish clear objectives for the outsourcing initiatives and carefully document baseline conditions
☐	Be open with the Service Provider about the current service delivery solution and your expectations for service delivery. Provide multiple touch points for dialogue and understanding during the outsourcing process
☐	Ensure critical systems are identified and provide increased oversight of the management of these systems
☐	Verify the Service Provider's references, internal organizational structure and proposed solution.
☐	Negotiate a contract structure with strong Client rights and Service Provider obligations. Transfer risk with responsibility
☐	Actively manage the transition as it sets the tone for the relationship.
☐	Have a longer term transformation plan as well as the near term transition (or implementation) plan
☐	Ensure post deal continuity. Manage according to the contract and ensure that there good communications across multiple levels in the partnering relationship. Define and follow an agreed upon dispute resolution process.
☐	Create a post deal Service Provider management program. Include regular reviews of performance and have a clear process to resolve disputes.

"With careful planning, risk can be minimized while maximizing the potential benefits of an Integrated Facility Management agreement."

Outsourcing presents some risks to the Client. However, these risks are not necessarily any greater than those posed by self-managed service delivery, and in some cases may be less. With careful planning, risk can be minimized while maximizing the potential benefits of an Integrated Facility Management agreement.

DEFINITIONS

Client: For the purposes of the paper “”Client” refers to the organization which owns the facility or facilities

Facility Management: An interdisciplinary field primarily devoted to the maintenance and care of large commercial or institutional buildings, such as office complexes, university campuses, research labs, convention centers and manufacturing buildings.

Integrated Facility Management: The delivery of all or most Facility Management services by a single, Service Provider who has broad accountability for service and cost performance.

Key Performance Indicators: The measurements used to track performance of a Service Provider and to determine incentive payments for good performance.

Out-tasked: The practice of using vendors to deliver specific services that are directed by the owner or “Client”

Service Provider: External organizations that can provided Integrated Facility Management services for building owners. The Service Provider may sub-contract some services to vendors.

Vendors: External organizations that provide limited, specific services. Typically responsible for performing tasks as opposed to having overall responsibility for facility performance.

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