



## What Drives Private Sector Contractors?

The main drivers of a successful FM Business  
Is there such thing as a “Win-Win” contract?  
What is achievable in a Contract Relationship

January 2016

**Presentation to APSE**





# Agenda

1. Evolution of Outsourcing
2. Why Outsource
3. Economics of Outsourcing
4. Conclusion



# Introduction

## Personal Background

### Professional Background

- 21 years in support services sector; 9 years in construction project management
- Building Services Engineer
- MBA from University of New South Wales

### Previous Roles

- MD, HOCHTIEF FM Ireland & UK
- Director, Tungsten Group, Australia
- General Manager, Haden FM Australia
- Past Chairman of Global FM & Facilities Management Association Australia

### Current Role

- **Director: Nodus Solutions Limited**
- *Chairman; BIFM Excellence Awards*
- *Chairman; BIFM International SIG*
- *Associate Lecturer; Sheffield Hallam University*

## Company Background

### Nodus; Latin for "knot"

*Nodus (n.pl) "A complicated situation or problem"*

- Privately owned
- Independent FM consultancy
- Working with a broad range of clients across the UK



BURBERRY  
ESTABLISHED 1856





# The only certainties in life... Death, Taxes and.....

## Outsourcing?

- Roman Empire
  - tax collection outsourced through competitive bidding process
- Early America
  - production of wagon covers outsourced to Scotland, where they used raw material imported from India in the production





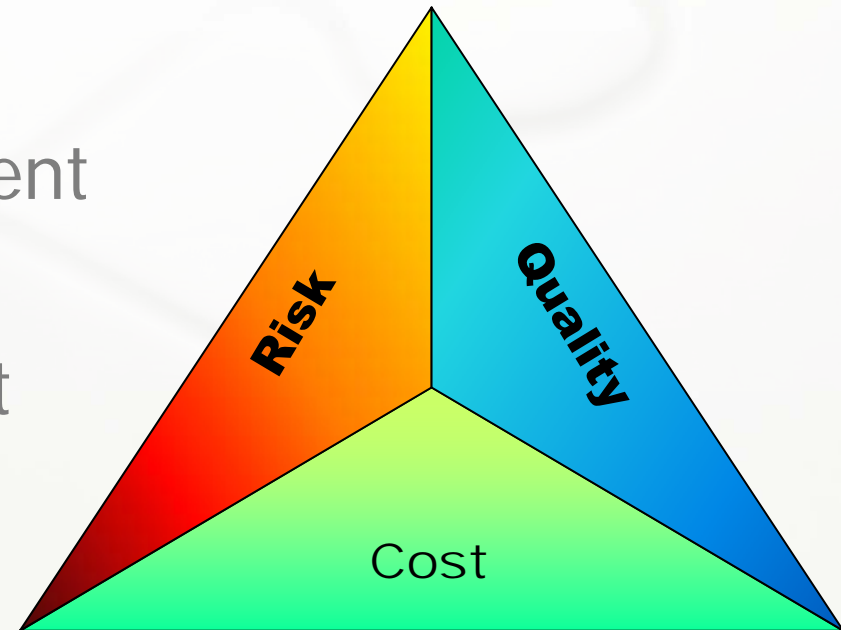
# Primary Reasons to Outsource

Key Area	Benefit of Outsourcing
<b>Specialisation</b>	Specialisation leads to demonstrable economic benefits. By concentrating on activities in which an organisation is relatively more efficient, total value added benefit is maximised. It also facilitates the exploitation of scale economies.
<b>Market Discipline</b>	Market discipline provides a range of benefits, namely, focus by the purchaser on outputs not inputs, competition between suppliers, choices by purchasers and innovative work practices.
<b>Flexibility</b>	Networks of small organisations linked to their clients via contract can adjust more quickly and at a lower cost to changing demand conditions compared to integrated organisations
<b>Cost Savings (1<sup>st</sup> Generation)</b>	International studies show that significant cost savings are achieved by outsourcing, on average in the order of 20% with first generation outsourcing. As a rule, efficiency gains need not to lead to lower quality.



- Risk transfer
- Service quality improvement
- Cultural change
- Career path enhancement

## Other Benefits



**European FM standard EN 15221-1:**  
"FM is the integration of processes within an organisation to maintain and develop the agreed services which **support and improve** the effectiveness of its primary processes."



Who are they?  
What do they have in common?





# Adam Smith 1776

## Self Interest & Division of Labour

Everyone acts in their own self-interest

- *"It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest"*
- *"Do what you do best; outsource the rest"*  
Tom Peters and Peter Drucker
- *"If a foreign country (company) can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage"*



*Adam Smith: 1776  
An Enquiry into the  
Nature and Causes of the  
Wealth of Nations*





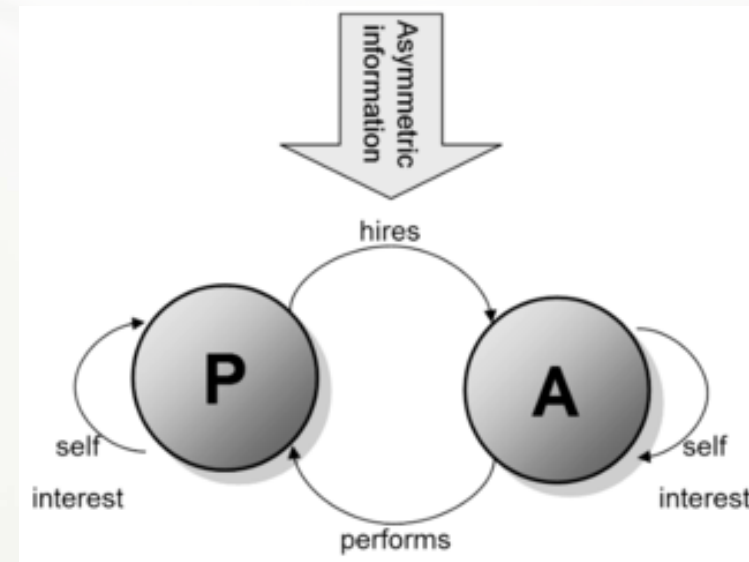
# Adam Smith 1776

## Self Interest & Division of Labour

The commercial model will drive the relationship model and behaviours

Motivating one party (the "agent"), to act in the best interests of another (the "principal") rather than in his or her own interests

### Principal Agent Challenge





# Questions, Questions

- So, What Drives Private Sector Contractors?
- Is it just Profit?
- Or are there other drivers to a successful FM Business?





# Develop Sourcing Strategy Commercial Model

## Service Provider Needs

1. Commercial risk mitigation
2. Make profit (4-6%)
3. Get paid on promptly
4. Long term secured forward order book
5. Demonstrate performance through references

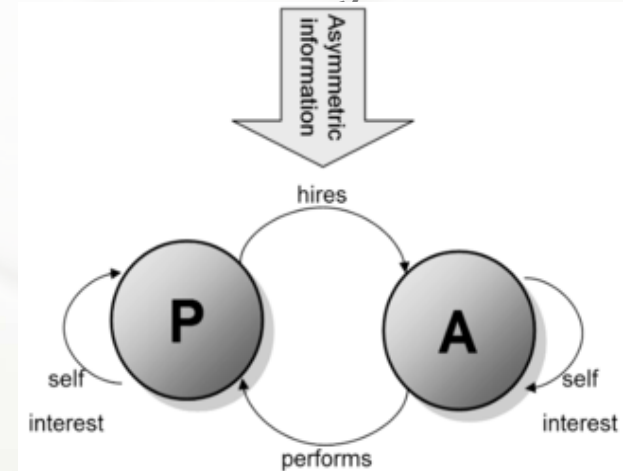
## Client Needs

1. Reduce risk (eg; compliance; safe working)
2. Asset management (Life cycle models)
3. Improve service (eg; client segmented SLA's)
4. Reduce cost (eg sustainable year on year savings)
5. Cultural change (eg proactive and innovative)

## Solution to "Self Interested" Needs

- Commercial model that drives outcomes for both parties
- Basic contract deliverables linked to monthly payment (**CPI's**)
- Risk and Reward mechanism with profits linked to performance **KPI's**)

## The Principal Agent Challenge

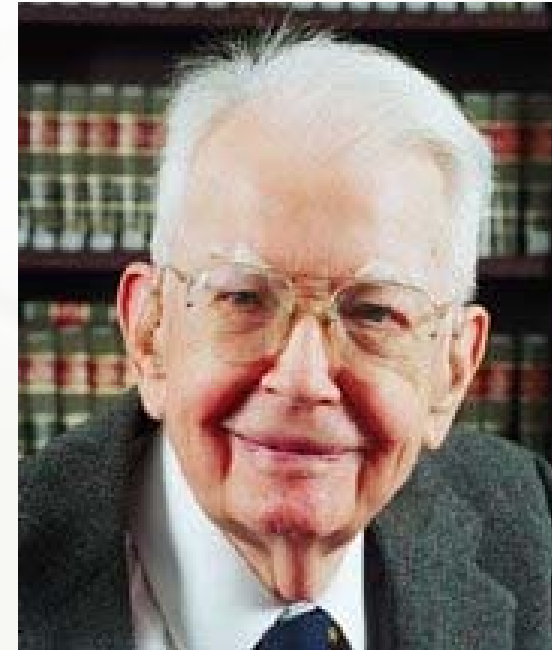




# Ronald Coase

## The Nature of the Firm – 1937

- Introduced the concept of transactional costs
  - *“Companies need to include the cost of entering into and executing contracts”*
- Coase Theorem laid the foundation for outsourcing to become a major part of an organisation’s calculations and strategy



*Ronald Coase  
Nobel Prize winner in Economic  
Sciences in 1991  
Professor Emeritus of  
Economics at the University of  
Chicago Law School*





*It's not how little you pay...  
It's how much you get*

- Total Cost - Accounting for all costs in every outsourcing relationship

*"In place of 'squeezing' suppliers for lower material or component prices, we are now looking to partner with a select few suppliers who have the expertise to look at the complete picture; suppliers who can see how their products or services impact their customer's operations, and make specific recommendations for improvement.*

*The value of these improvements can add substantially to the bottom line—much more than the relatively small gains from price concessions"*

### **Ronald Coase in Practice**



**"Total Cost of Ownership:  
It's not how little you pay, it's how much you get"**

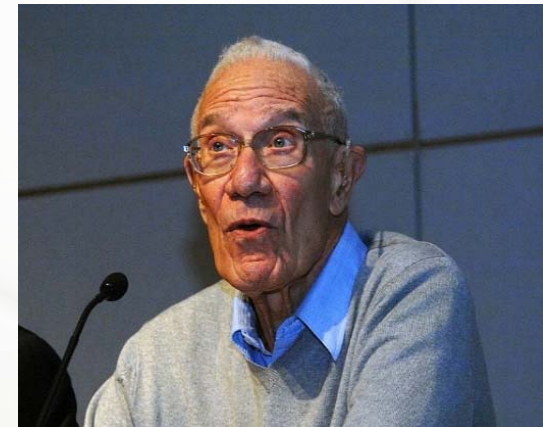
Todd Snelgrove, SKF's Group's General Manager, Value.



# Robert Solow - 1956

## Innovation makes the difference

- *“Technological improvements (improvements in business processes or products) are the major driver of economic growth”*
  - 13% of annual growth due to labour and capital
  - 87% of growth due to technological improvements in products and business process
- Companies that outsource searching for lowest cost of labour or facilities are missing the value of outsourcing
- Outsourcing relationships must focus on innovation to lead to long term sustainable growth



Robert Solow

Nobel prize winner in economic Sciences in 1987

Breakthrough connection between innovation and economic growth

(1956 - “A Contribution to the Theory of Economic Growth”)



# Oliver Williamson - 2009

“Style matters if you don’t play nice, you’ll end up paying more”

- Transaction cost economics (TCE)
- Entire cost of doing business with a particular focus on the cost of the contracting, negotiations and governance processes
  - *“all complex contracts will be incomplete—there will be gaps, errors, omissions, and the like”*
- More flexible contracts should allow and encourage contracts to be reviewed to keep the relationship fair
- Rigorous contracts lead to higher transaction and hidden costs



**Oliver Williamson**

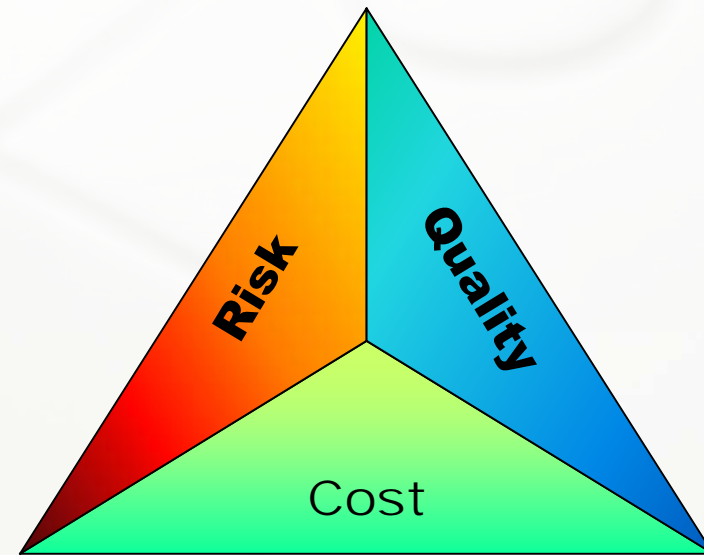
Nobel Prize Winner in 2009 has taken threads from Smith, Coase and others, added a few of his own, and weaved them directly into modern outsourcing. Williamson may be the most influential of the economic scientists for our industry. A professor emeritus of business, economics, and law at the University of California at Berkeley



*"Use a credible style of contracting that builds long-term trust"*

*"Muscular buyers not only use their suppliers, but they often 'use up' their suppliers and discard them"*

*"Organisations that flex their muscle to gain an advantage over suppliers may get a short term win, but they will lose over the long term"*



**European FM standard EN 15221-1:**  
"FM is the integration of processes within an organisation to maintain and develop the agreed services which **support and improve** the effectiveness of its primary processes."



## Win-Win

- Is there such thing as a “Win-Win” contract?
- Or is this just a modern day business motherhood statement?





# John Nash - 1994

## It Pays to Play Win-Win ( $1+1=3$ )

- Playing cooperatively from the start of a contract to achieve mutually beneficial goals is good for everyone, and will almost always yield the best result
- Vested Outsourcing
  - Collaboration
  - Innovation
  - Mutual trust to share value and achieve the win-win in an outcome-based environment in which the parties are vested in each other's success
- The sum of the parts can be greater when combined effectively through companies working together than if they work at cross-purposes
- Outsourcing to experts should ensure their ability to reach their goals
- Seminal in the development and success of modern outsourcing

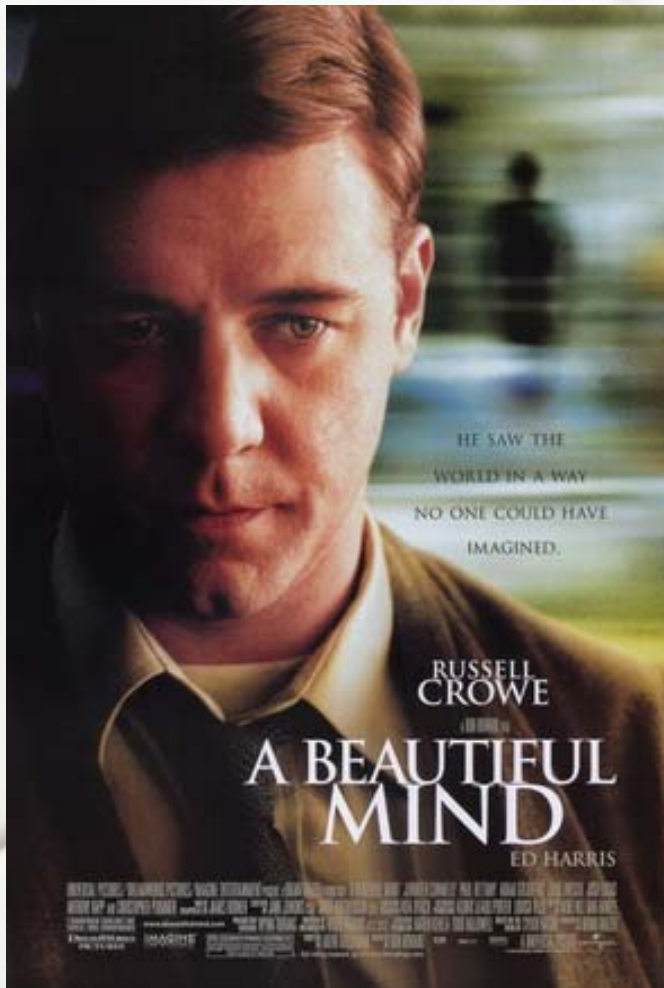


John F. Nash, a mathematician and Nobel Laureate, took economists a step beyond Adam Smith with his ideas on Game Theory and the art of collaborating for the “win-win.” Nash received the Nobel Prize in 1994.



# John Nash - 1994

## Reaching Equilibrium (Win-Win)



- Contracting collaboratively to achieve mutual goals is always better than playing it with self-interest
- **Win-win is not:**
  - a contest
  - a game of one-upmanship
  - an abdication by one party to another
- **Win-Win is:**
  - a collaboration
  - a structured framework
  - a relationship with regular communication
- Nash's genius was in showing the value of reaching equilibrium, or win-win solutions in difficult scenarios, as the way to achieve successful business and outsourcing relationships

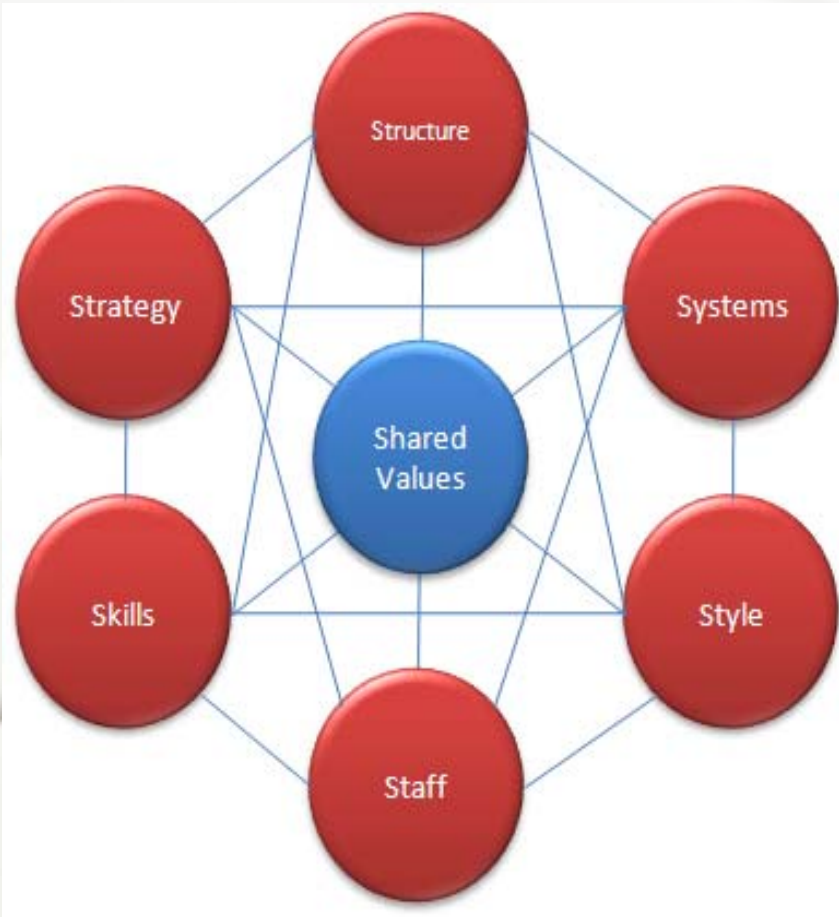


# Economic Lessons in all Contracts

1. Adam Smith
  - Everyone acts in their own self interest
2. Ronald Coase
  - Importance of looking beyond price and embracing a total cost of ownership approach when making outsourcing decisions
3. Robert Solow
  - Importance of innovation in outsourcing deals
4. Oliver Williamson
  - Style matters: not playing nice can increase transaction costs!
5. John Nash
  - “Win-Win” the best results come from all parties collaborating to achieve a common goal

# Final Thoughts

## Importance of Cultural Fit



## Collaborative Process

### *BS 11000 eight stage model*





# Collaborative Win-Win

*"None of us is as good as all of us"*

- Bundled hard and soft service contracts
- Strategic Fit model used to evaluate and select the "right" fit providers
- All transaction costs considered
- BS 11000 collaborative business relationship framework
- NEC 3 flexible and transparent contract
- Structured Relationship Management plan that all parties signed up to

*Smith, Coase, Nash, Solow  
& Williamson in Practice*



UNIVERSITY OF  
LINCOLN





## *“None of us is as good as all of us”*

*At the University of Lincoln we have formulated a joint collaboration for the delivery of all hard and soft services.*

*The collaboration sees our two organisations integrating with the University Estates and Commercial Facilities Team to form a one stop service provision for the end user. The contract runs under NEC terms to ensure best value,*

*As such the University engaged Nodus as a consultant to work with the team to assist with us achieving our combined goals and aspirations with regard to delivery, innovation and savings.*

*Nodus has acted as an independent ear so to speak helping the team to stay on track during the initial mobilisation on to transition and them ultimately into the transformation stage of the process.*

*Nodus has engaged all parties individually and together helping us all to realise the challenges and to challenge each other which has made a significant impact and helped us all to strive for the continual improvements we demand of each other.*

*It has been the independent insight that has often been helped the team recognise some of our own shortfalls but also to promote all of the great results we have achieved to date.*





**steve.gladwin@nodussolutions.co.uk**

**+44 7753 244 685**

**Linked In**

