

Comment on outsourcing for Wellington City Council

In discussing the issue of outsourcing there is no automatic “correct” answer: whether all services should be done in-house, or all outsourced.

Delivering services in-house has intuitive logic. The Council can control the level, cost and quality of services directly. However, outside providers may be able to do so at lower cost, hopefully because they are more innovative and efficient, but also perhaps because they pay lower wages, or trim back quality.

There is no presumption that in-house services will be lower cost. In normal circumstances there is a cost “wedge” that has to be overcome. The external provider needs to make a profit and pay taxes on it. For the Council, there are costs of developing the contract, monitoring it, and dealing with variation and non-compliance.

The literature does not reach any *predetermined* conclusions. It depends on time, place and circumstance.

What the literature *does* is identify risks with moving away from in-house provision. These risks suggest that good decision making considers the longer term, and does not simply compare a bid with the current cost of providing it.

This is because suppliers make loss-leader type bids to establish what is known as a “foot in the door monopoly”. It is difficult for rival bidders to maintain a

Tabled Information Reference 020/13C(a)

capacity to supply a specialist service in case it is retendered at some time in the future. Competition keeps the provider honest, but the more specific the service is, the less likely it is that rivals will stay in the market. The most effective tactic the local body has to restrict leverage is to maintain a threat of taking the service back in house. This requires it to have some capacity to scale up if a contract cannot be renewed satisfactorily.

Keeping capacity in house also helps monitoring and enforcing the terms of a contract. Finally, where volumes of future work are uneven and unpredictable, contracting is doubly difficult.

All of this is somewhat theoretical, but we can draw on the recent experiences of the Kaipara District Council. It got into financial difficulties and the Minister appointed a review team to look at it.

Its report notes that a high degree of outsourcing creates a high degree of consultant capture, a loss of institutional knowledge and control of intellectual property, and leaves the council in a weak position to set policy and undertake planning and asset management. Note that the *degree* of outsourcing is an important contributor to a weakening of the position of the Council.

The recommendations suggest that the interface between Council's in-house functions and outsourced be reviewed to ensure that the Council retains

Tabled Information Reference 020/13C(a)

control of policy development, service planning, customer services and asset management. I would put the emphasis here on the word *control*, because the key issue is how effective it is.

The team recommended that a service delivery policy (and here I would emphasise the word *policy*) is developed that addresses:

- the need to retain core functions and intellectual property in-house,
- the practicality of outsourcing,
- the costs of procuring and administering it, and
- the appropriate allocation of risks.

I leave the final words to the review team.

“Contracting out both the service delivery and the oversight of that work..is risky as there is a loss of control and institutional knowledge.”